



Governance and Priorities Committee Report

For the Meeting of March 26, 2015

To: Governance and Priorities Committee
From: Susanne Thompson, Director, Finance
Subject: Reserve Fund Policy Review

Date: March 10, 2015

Executive Summary

The purpose of this report is to outline the results of the reserve fund policy review and seek Council direction on changes to the policy and bylaw.

As part of the financial planning process and at the request of Council, a review of the City's Reserve Fund Policy was initiated. This review included determining whether the purpose of each reserve fund is still relevant, as well as determining target balances for each reserve.

Based on the findings, the purposes for the majority of the reserves are still relevant. However, it is recommended that the Economic Development Reserve, which is a capital reserve, be eliminated since it has no current funding source and has not been used in more than five years; remaining funds are proposed to be transferred to the Buildings and Infrastructure Reserve. The economic development initiatives in the draft Strategic Plan would be funded through the operating budget; the draft Financial Plan includes \$250,000 in annual funding. There is also overlap between the Financial Stability Reserve and the Fiscal Reserve. The Fiscal Reserve is comprised of three sub-sets: Debt Reduction, Insurance Claims and Working Capital. It is recommended that the Fiscal Reserve be transferred to the Financial Stability Reserve, keeping the sub-sets for Debt Reduction and Insurance Claims, but merging the Working Capital into the main Financial Stability Reserve. Finally, the City has a Strategic Planning Initiatives Reserve that has not been used since 2006. It is recommended that the funding in this reserve, approximately \$143,000, be used to partially fund some capital strategic plan initiatives as determined by Council, such as quality-of-life infrastructure for the Douglas/Blanshard Corridor, park improvements, or cycling network projects.

The proposed methodology for the target balances varies for each type of reserve as outlined in Appendix D. The proposed target balances for many of the reserves are linked to the capital plan; for these capital reserves balances are proposed to be a percentage of replacement value plus investment needs as outlined in the capital plan.

The review findings concluded that the City's reserve policies are strong in addressing what is known. Since 1999, Council has approved significant funding increases for infrastructure investment; the annual contribution to the Buildings and Infrastructure Reserve more than tripled from \$1.5 million to over \$5 million proposed in 2015, and capital spending funded by property taxes increased from \$2.5 million to over \$13 million during the same period. The capital plan incorporates funding identified through asset management plans (for example underground

infrastructure and roads), equipment replacement schedules and ongoing condition assessments for infrastructure such as street and traffic lights, playgrounds and sports fields.

However, due to a significant element of unknown capital needs, especially in relation to facilities, reserve balances need to be higher than if all needs were known to mitigate against unknown risks. A facilities assessment is currently underway, scheduled for completion in October 2015, which will reduce this information gap. At that time, target balances for all the reserves related to City facilities (Buildings and Infrastructure, Recreation, Parking, Multipurpose and Victoria Conference Centre) as well as the associated annual funding contributions to these reserves will be calculated to ensure that sufficient funding is available.

Another information gap is in relation to the Tax Sale Lands Reserve and Parks and Greenways Acquisition Reserve. These reserves are typically opportunistic reserves. However, having a property and parks acquisition plan would enable long-term planning to ensure that sufficient funding is available when opportunities arise.

The City's equipment reserves and the water and sewer utilities' equipment and infrastructure reserves have sufficient funding based on the proposed methodology as do the financial stability reserves for the general fund. The financial stability reserves for the water and sewer utilities have to-date not been allocated any funding and it is recommended that the City start contributing to these reserves through annual surpluses within the utilities. To-date all surpluses for utilities have been transferred to their respective equipment and infrastructure reserves.

Recommendation:

That Council:

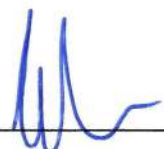
1. Approve the methodology for determining target balances for each reserve as outlined in Appendix D of this report for inclusion in the Reserve Fund Policy.
2. Transfer the funding in the Economic Development Reserve to the Buildings and Infrastructure Reserve.
3. Transfer the funding in the Fiscal Reserve to the Financial Stability Reserve keeping the subsets of Debt Reduction and Insurance, but merging Working Capital with the main reserve.
4. Amend the Reserve Fund Bylaw, 2004 by:
 - a. Eliminating the Economic Development Reserve
 - b. Eliminating the Fiscal Reserve
5. Amend the Reserve Fund Policy for the water, sewer and stormwater utilities to direct 50% of each utility's surpluses to the respective financial stability reserve until they reach target balances and the remainder to the respective equipment and infrastructure reserve.
6. Direct staff to bring forward options for the use of the funding in the Strategic Initiatives Reserve timed with the report on public input on the draft Strategic Plan.
7. Direct staff to report back on recommended target balances and annual funding contributions for all reserves related to facilities once the facilities assessment is complete.
8. Direct staff to annually report to Council on the status of all reserve funds.

Respectfully submitted,


Susanne Thompson
Director, Finance

Report accepted and recommended by the City Manager:

Date:


March 20, 2015

Attachments:

Appendix A - Reserve Fund Policy

Appendix B - Reserve Fund Bylaw

Appendix C - *Community Charter* Sections 188 and 189

Appendix D - FCS Group Reserve Fund Review Report

Appendix E - Recommended Target Balance Methodology

Purpose

The purpose of this report is to outline the results of the reserve fund policy review and seek Council direction on changes to the policy and bylaw.

Background

As part of the financial planning process, a review of the City's Reserve Fund Policy (attached as Appendix A) was initiated with the assistance of an external consultant, FCS Group. This review included determining whether the purpose of each reserve fund is still relevant, as well as determining target balances for each reserve.

The two primary purposes of reserves are to serve as a capital funding mechanism and to mitigate risk. As such, reserves work in conjunction with the City's policies and practices on debt, infrastructure needs and capital plan funding. The following outlines information regarding the City's reserves, debt, infrastructure deficit and capital plan funding.

Reserves

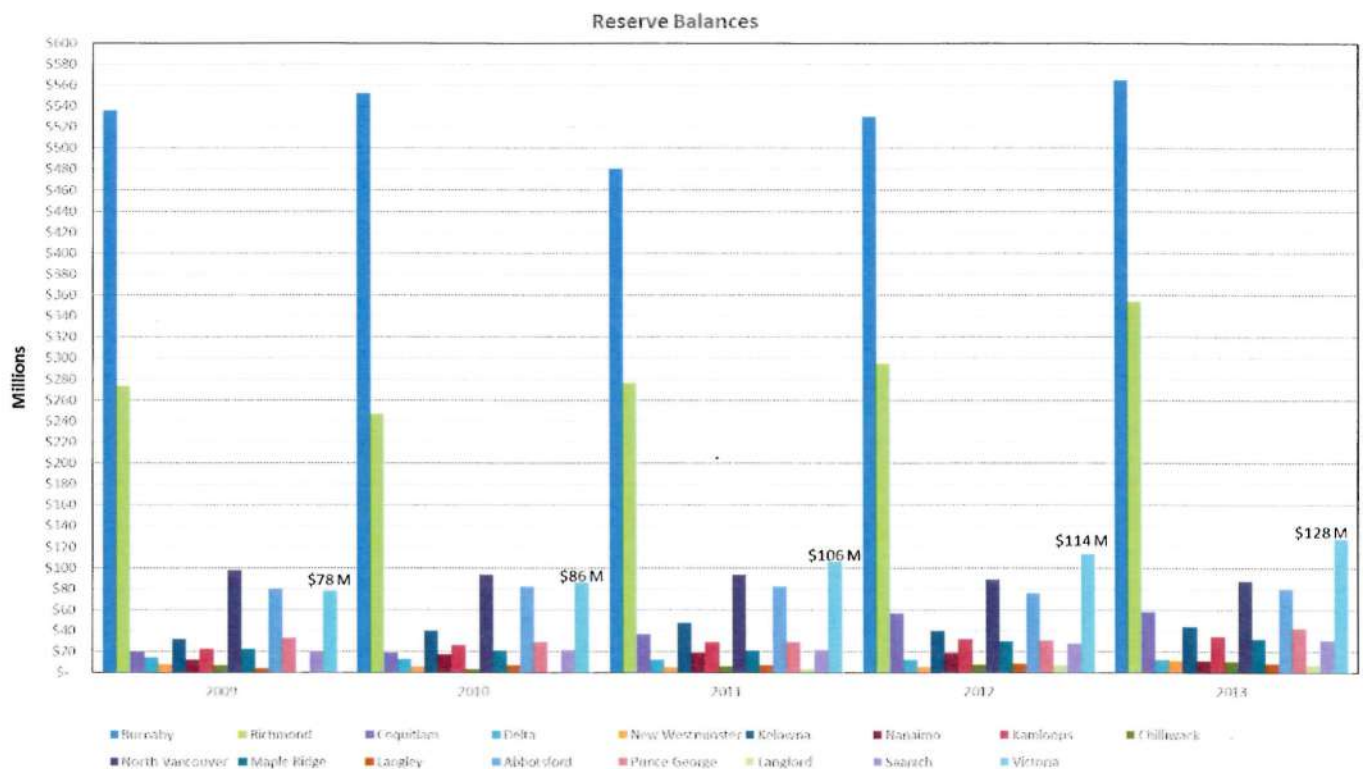
The City's reserves were established by bylaw (Appendix B) under section 188 of the *Community Charter* (Appendix C). The legislation requires that money in a reserve fund must be used for the purpose for which the fund was established. However, Council can make changes to reserve funds, including eliminating them, if the amount in a reserve is greater than what is required for the purpose for which the fund was established. There are some restrictions to this, including that funding in a capital reserve must be transferred to another capital reserve.

The City's Reserve Fund Policy outlines the purposes for each reserve and how the funding can be allocated. The majority of the City's reserves are used for capital purposes. The estimated balances in each reserve at December 31, 2014 total approximately \$158 million as outlined in the following table:

Description	Estimated Balance 31-Dec-14	2015 Budget Contribution	2015 Planned Expenditures/ Commitments	Estimated Balance 31-Dec-15
CAPITAL RESERVES				
Equipment & Infrastructure				
Police				
Police Vehicles, Equipment & Infrastructure	2,165,477	1,000,000	1,566,000	1,599,477
Police Emergency Response Team	238,616			238,616
City				
VCC Equipment and Infrastructure	673,182		250,000	423,182
City Equipment	7,016,893	1,602,500	1,654,820	6,964,573
City Vehicles & Heavy Equipment	5,781,045	1,500,000	2,965,000	4,316,045
City Buildings & Infrastructure	38,568,507	5,378,393	12,681,349	31,265,551
Parking Services Equipment and Infrastructure	5,523,579	807,540	1,737,000	4,594,119
Multipurpose Equipment and Infrastructure	675,018	112,500		787,518
Recreation Facilities Equipment and Infrastructure	945,022			945,022
Archives Equipment	49,728			49,728
Strategic Planning Initiatives	143,532			143,532
Artificial Turf Field	706,150			706,150
Gas Tax	8,439,766	3,200,000	2,492,200	9,147,566
Water Utility Equipment and Infrastructure	8,488,272	1,850,000		10,338,272
Sewer Utility Equipment and Infrastructure	20,614,264	1,680,536		22,294,800
Stormwater Utility Equipment and Infrastructure	0			0
	100,029,052	17,131,469	23,346,369	93,814,152
Economic Development	743,626			743,626
Tax Sale Lands Fund	7,201,808	50,000	3,036,900	4,214,908
Parks and Greenways Acquisition Fund	2,297,832		500,000	1,797,832
Debt Reduction	25,319,981	3,509,187		28,829,168
Local Amenities Reserve	522,121			522,121
Development Cost Charges	8,457,604		53,000	8,404,604
Downtown Core Area Public Realm Improvements	58,090			58,090
Sub-total Capital Reserves	144,630,114	20,690,656	26,936,269	138,384,501
OPERATING RESERVES				
Financial Stability Reserves				
City	2,022,096			2,022,096
Police	928,678			928,678
Fiscal Reserve				
Insurance Claims	3,780,040			3,780,040
Working Capital Fund	3,885,046			3,885,046
Victoria Housing Reserve *	1,901,083	250,000	1,901,083	250,000
Dockside Affordable Housing	239,614			239,614
Climate Action Reserve	505,768	90,000		595,768
Art in Public Places	436,960	135,000	145,000	426,960
Heritage Buildings Seismic Upgrades	19,363			19,363
Sub-total Operating Reserves	13,718,647	475,000	2,046,083	12,147,564
Total Reserves	158,348,761	21,165,656	28,982,352	150,532,065

*Based on approved applications for funding from the Victoria Housing Reserve.

As the consultant has mentioned in his report, comparatives with other municipalities are not necessarily indicative of what the City should have in its reserves. However, the following table outlining reserve levels in other BC municipalities is provided for information. These balances do not include Development Cost Charges since they are not considered reserves in reporting to the Province.



As the table shows, the City's reserve balances have been increasing over the last number of years.

Debt

The maximum amount the City can borrow from external sources is set by section 174 of the *Community Charter*. The debt servicing costs cannot exceed 25% of revenues as calculated based on this legislation.

The City's Financial Sustainability Policy guides debt management. It limits debt principal and interest payments, excluding utilities and other self-funded areas, to \$7.8 million. This limitation is in place to ensure there is no increase in property taxes as a result of new debt. This policy does not apply in situations such as the purchase of the property at 812 Wharf Street since that property generates sufficient revenues to offset the repayment of the amount borrowed from reserve (it is self-funded).

The following are the debt management policies in the Financial Sustainability Policy:

Debt Management

The maximum amount that the City can borrow from external sources is set by the Community Charter. Debt should only be incurred for one-time capital expenditures and not for on-going programs. Borrowing for one-time capital expenditures allows the cost of the project to be

spread out over the useful life of the asset. This results in the costs being paid by future beneficiaries as well as current taxpayers.

Policy 8.0

Debt from external sources should only be incurred for one-time capital projects. These projects should be identified as debt-funded projects in the Five-year Financial Plan and 20-year Capital Plan. A separate report, including a business case, to Council is required seeking approval for proceeding with the borrowing process.

Policy 8.1

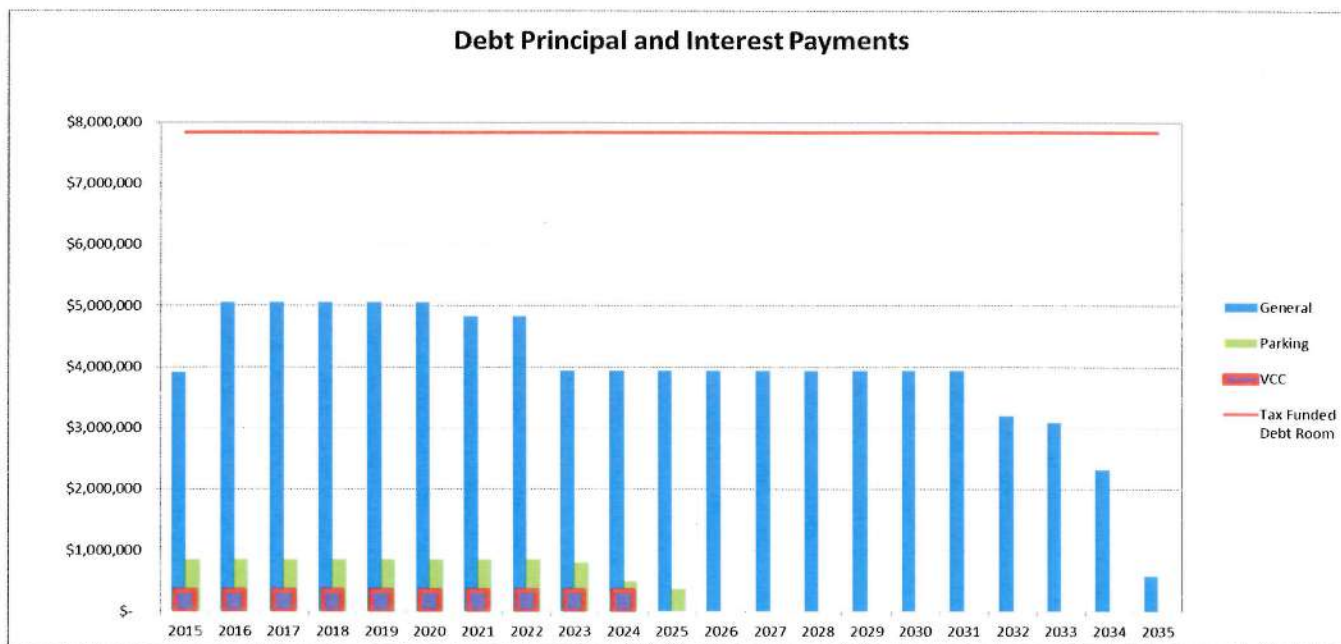
Every attempt should be made to keep the debt servicing charges at the current budget level by adding new debt only in the years when other debt issues are retired. This will ensure that there is no additional budget impact and in turn no increase in property taxes as a result of new debt.

Policy 8.2

Debt for Self-financed entities (Water Utility, Sewer Utility, Victoria Conference Centre, and Parking Services) can be incurred if supported through a business case, without consideration of Policy 8.1 which only applies to projects that impact on property taxes.

On January 22, 2015, Council directed staff to review the Financial Sustainability Policy including adding internal borrowing through the City's Debt Reduction Reserve that can be used as a revolving loan fund which is repaid over time. This review will be completed in the fall in time for the 2016 financial planning process.

The following table outlines the City's current debt payments as well as estimates for planned debt for the Johnson Street Bridge.



As the chart indicates, the City currently has room to take on additional debt within the existing principal and interest payment budget cap. Council has provided direction regarding the use of internal borrowing within this available room.

On October 10, 2013, Council endorsed the use of internal borrowing through the City's Debt Reduction Reserve to fund a portion of future options for the Fire Hall #1 and the Crystal Pool and Fitness Centre. The following is the motion:

It was moved by Councillor Madoff, seconded by Councillor Isitt, that the amendment to the motion be amended as follows:

That Council:

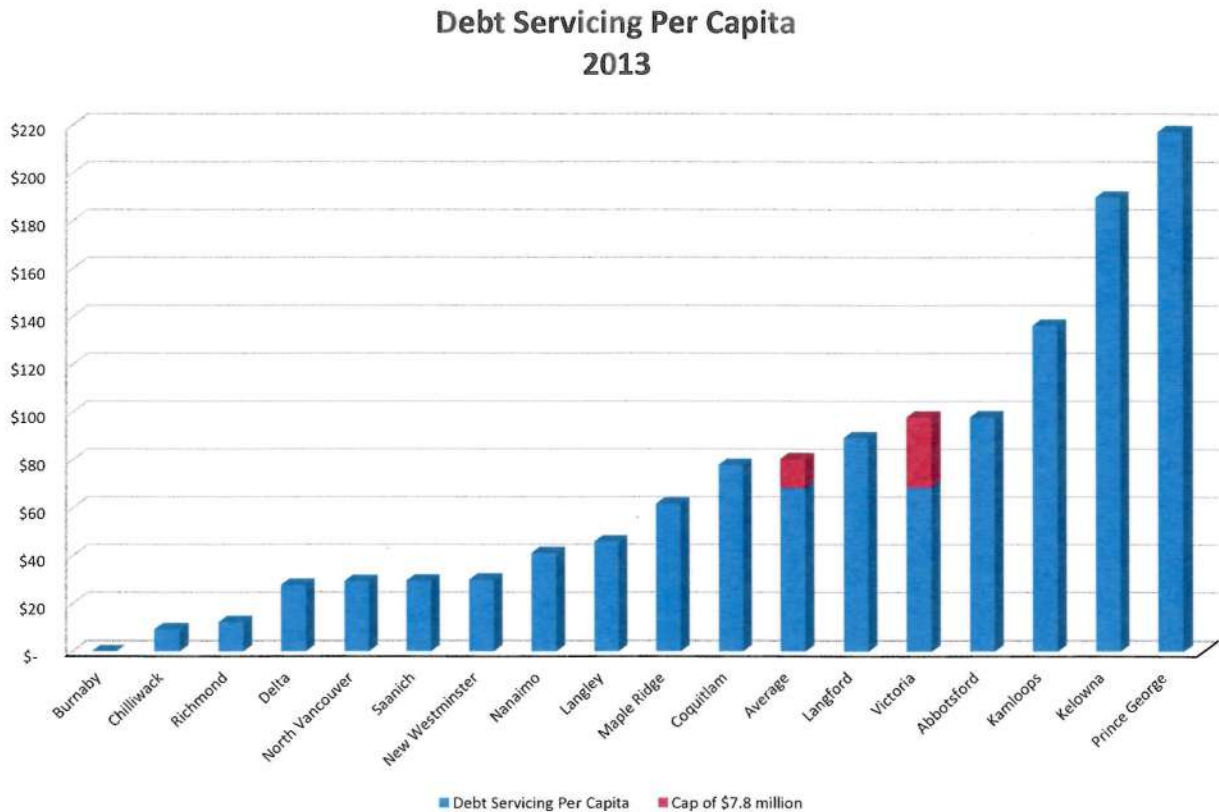
1. Endorse the following funding strategies for the future option for the Crystal Pool and Fitness Centre and the future option for the Fire Hall #1 (amounts to be determined once decisions on options have been made):
 - a. Internal borrowing from the Debt Reduction Reserve
 - b. Grants and partnerships that are consistent with the public ownership and operation of a pool and fitness centre in Victoria and consistent with the Council resolution of October 27, 2011

Based on current interest rates, the funding available within the principal and interest payment budget cap is approximately \$2.7 million. The Debt Reduction Reserve has a balance of approximately \$25 million. The amount of funding available within the \$2.7 million cap is dependent on the life of the capital investment; the City's typical practice is to borrow over a maximum of 15 years, but no longer than the life of the asset which is consistent with legislation.

The following table lists the final year of payment of the City's outstanding debt. This does not include the final \$15.1 million yet to be borrowed for the Johnson Street Bridge.

Final Year	Issue	Description	Total
2020	95	Fire Department Building Upgrades	115,996.55
2022	102	Burnside Gorge Community Centre	221,700.75
	102	City Hall Accessibility	220,817.48
2023	103	Parkades	173,593.98
	105	Parkades	178,093.98
2024	105	Crystal Gardens	340,358.87
2025	110	Parkades	493,693.72
2031	115	Johnson Street Bridge Replacement (CMHC)	743,241.49
2033	79	Multipurpose Arena	360,514.34
2033	80	Multipurpose Arena	390,514.34
2034	81	Multipurpose Arena	390,514.35
2034	130	Johnson Street Bridge Replacement	1,475,096.61

Comparatively, based on 2013 statistics, the City's debt servicing costs per capita is average. With the additional borrowing room within the \$7.8 million cap and assuming the other municipalities do not incur additional debt, the City's debt servicing costs per capita would be higher than the average for these municipalities.



Infrastructure Deficit and Capital Plan Funding

Aging infrastructure is a challenge facing most municipalities in North America. The infrastructure deficit has two components: annual capital budget funding and reserve fund levels for infrastructure renewal. This is the total funding needed if only reserve funds were used to fund infrastructure renewal. However, many municipalities, including the City, have policies that use a combination of funding sources such as debt, grants, property taxes and reserves. Therefore, the actual funding needed for annual capital budget spending and reserves is dependent on the policy choices of the municipality. The municipality makes choices in regards to the capital investment it undertakes each year such as:

- Choices between projects or choosing various scope of projects to manage costs;
- Increasing funding through borrowing for which repayment may need a tax increase;
- Applying for grants to offset all or a portion of the cost of projects; and
- Increasing taxes to increase funding

The annual capital investment needs are determined through asset master plans and condition assessments. Asset master plans outline the level of funding that is considered sustainable to maintain current service levels and the priorities for infrastructure investment. The capital budget funding levels have reached sustainable levels for some assets (water), some are close to sustainable levels (storm drains), some projects are shaped through consultation with the community (park upgrades, greenways and bike lanes), some have funding levels that fall short of

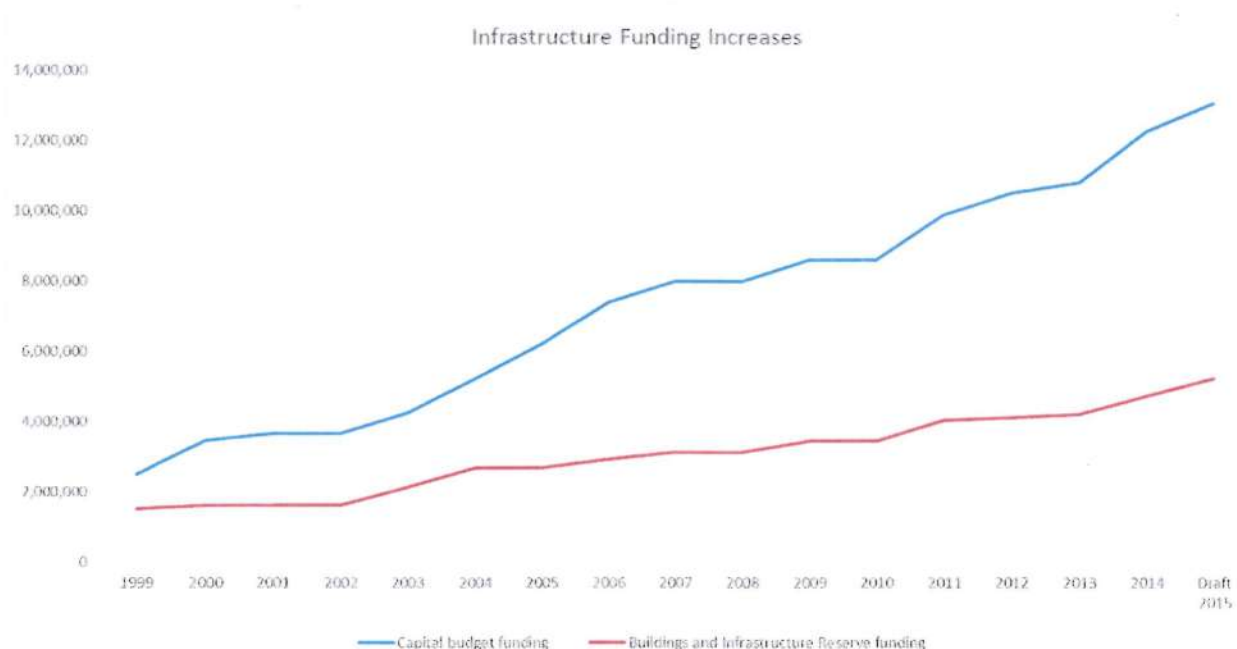
industry-recommended replacement schedules (playgrounds) and some require additional analysis to determine the required funding levels (pavement, facilities, sewer, and street and traffic lights).

Historically, the City's capital plan, for the upgrades and replacement of the City's approximately \$1.9 billion in asset replacement value, has been funded by a combination of property taxes, utility user fees, grants, debt and reserves. Approximately one third of the City's typical \$30-\$35 million capital budget is funded from reserves for investments such as vehicle and equipment replacements, remediation of City properties, and some building upgrades. Larger projects, such as a bridge replacement or construction of an arena, have primarily been funded through debt and grants.

The Financial Sustainability Policy, which is under review, contains funding strategies to address infrastructure funding needs:

1. To increase capital spending:
 - a. Levy an annual 1.5% increase in property taxes (1.25% in 2015)
2. To increase reserve fund levels:
 - a. Transfer all new assessment revenue to infrastructure reserves
 - b. Transfer annual operating budget surplus to infrastructure reserves

Since 1999, the City has significantly increased its infrastructure investment through both reserve fund contributions and annual capital spending as depicted in the following graphs:



Issues & Analysis

The following summarizes the consultant's review findings. The full report is attached as Appendix D.

1. Policy development and purpose of reserves

Policies involve an element of choice. The goal of the policy review is to research best practices and develop the policy rationale to guide decision making.

A reserve is intended to accumulate a fund balance for a defined future need or a potential need. A reserve that is always growing and never used is not accomplishing its purpose. Particularly for capital reserves, fluctuations mean that the reserve is being used and is needed.

In general, there are two primary purposes of reserves: capital funding mechanism (save up in advance of need to smooth impact of large investments); and to address risks of various types. One area of overlap between risk reserves and capital reserves is when insufficient information is available about capital needs. Capital reserves offer both a vehicle for planned funding of known capital needs and also a contingency in the event of capital needs that are large, urgent and unplanned. Therefore, target balances for capital reserves need to be higher in the absence of complete information.

The consultant's findings have concluded that the purposes for the majority of the City's reserves are still relevant, with the exception of the Economic Development Reserve, which has not been used in a number of years and has no current funding sources, and the Fiscal Reserve which overlaps with the Financial Stability Reserve.

2. Methodology for Determining Target Reserve Fund Balances

The goal of the review was to develop a methodology for determining the balances for each reserve, rather than determining fixed amounts. The research analyzed the following:

- a. comparisons with other jurisdictions
- b. Government Finance Officers Association best practices
- c. City's own policies and historical commitment to reserve funding
- d. balancing of planned reserves against known capital needs (smoothing the demand)
- e. total existing capital assets to assess the risk of the unknown capital needs.

It is recommended that reserve balances be determined based on the following four categories:

- a. planned capital funding
- b. risk mitigation
- c. dedicated revenue source
- d. planned future obligations

Appendix E outlines the proposed methodology for each reserve.

Based on current information, the City's equipment reserves and the water and sewer utilities' equipment and infrastructure reserves have sufficient funding as do the financial stability reserves for the general fund. The financial stability reserves for the water and sewer utilities have to-date not been allocated any funding and it is recommended that the City start contributing to these reserves through annual surpluses within the utilities. To-date all surpluses for utilities have been transferred to their respective equipment and infrastructure reserves.

A number of the City's reserves are related to facilities (Buildings and Infrastructure, Recreation, Parking, Multipurpose and Victoria Conference Centre.) The target balances for those are dependent on the information currently being gathered as part of the facilities assessment that is scheduled for completion in October. A report will be brought to Council outlining target balances for these reserves at that time. Also, due to the current unknown needs for facilities such as the library, police headquarters, City Hall and the curling club, it is recommended that the annual contributions to reserves, particularly the Buildings and Infrastructure Reserve, be reviewed once the facilities assessment is completed to ensure that sufficient funding is available.

Recommendations

That Council:

1. Approve the methodology for determining target balances for each reserve as outlined in Appendix D of this report for inclusion in the Reserve Fund Policy.
2. Transfer the funding in the Economic Development Reserve to the Buildings and Infrastructure Reserve.
3. Transfer the funding in the Fiscal Reserve to the Financial Stability Reserve keeping the subsets of Debt Reduction and Insurance, but merging Working Capital with the main reserve.
4. Amend the Reserve Fund Bylaw, 2004 by:
 - a. Eliminating the Economic Development Reserve
 - b. Eliminating the Fiscal Reserve
5. Amend the Reserve Fund Policy for the water, sewer and stormwater utilities to direct 50% of each utility's surpluses to the respective financial stability reserve until they reach target balances and the remainder to the respective equipment and infrastructure reserve.
6. Direct staff to bring forward options for the use of the funding in the Strategic Initiatives Reserve timed with the report on public input on the draft Strategic Plan.
7. Direct staff to report back on recommended target balances and annual funding contributions for all reserves related to facilities once the facilities assessment is complete.
8. Direct staff to annually report to Council on the status of all reserve funds.

Appendix A – Reserve Fund Policy

<i>Policies and Procedures</i>	
Reserve Funds	
Authorized by: City Council	Date of issue: September 30, 2004 Revised: September 2, 2014

Purpose

The purpose of the Reserve Fund Policy is to provide guidance with respect to the development, maintenance, and use of City Reserve Funds.

Guiding Principles

All Reserves Funds must be established, maintained and used for a specified purpose mandated by this policy, statute, or City by-law.

Annual operating surpluses are to be transferred to the Equipment and Infrastructure Reserve or the appropriate Financial Stability Reserve in each fund and used in accordance with the priorities outlined in this policy.

The City shall strive to develop appropriate reserves to meet future financial obligations with respect to City equipment and infrastructure, fiscal needs and employee benefit obligations.

Primary Objectives

Reserves shall be established and expended to:

1. Ensure Stable & Predictable Levies

The City recognizes that unstable and unpredictable tax levies can adversely affect residents and businesses in Victoria. In order to maintain stable and predictable levies, the City will maintain sufficient reserves to buffer the impact of unusual or unplanned cost increases and revenue reductions over multiple budget cycles.

2. Provide for Operating Emergencies

The City is exposed to unusual operating emergencies resulting from inclement weather, catastrophic events, law enforcement issues, environmental hazards and so on. It may not be feasible, or cost-effective, to absorb the costs of such emergencies during one budget cycle. The City will maintain adequate reserves to avoid such emergencies, extensive service interruptions, and prevent risks to infrastructure and public safety.

3. Finance New Capital Assets

Use of Reserves for financing new capital assets is an effective means of matching one-time funds to one-time capital projects. In addition, the City requires financial resources to quickly respond to opportunities that could provide capital infrastructure through private sector partnerships, and other alternative service delivery methods.

4. Safeguard and Maximize Existing Assets

The City has an inventory of specialized machinery, equipment and technology systems necessary for the efficient delivery of services to the public, which needs to be replaced on well-defined lifecycle standards. The City also has a need to provide insurance against unforeseen losses of these and other assets and claims against its assets where it is found legally liable.

General Criteria

Reserves shall be established, maintained and used in accordance with the following General Criteria.

1. Least Cost to Taxpayers

Reserves should support the least cost alternative in the long-term for delivering standards of service adopted by Council. This means they will be used to:

- Buffer the effects of large cost increases and revenue reductions and allow time to adjust City service costs or revenue generation to avoid unnecessary tax increases, and
- Provide internal capital financing which is more cost-effective than external borrowing or leasing.

2. Fairness & Equity to Taxpayers

Reserves should serve to balance the impact of the operating costs and capital costs, on both current and future taxpayers by:

- Applying Reserves derived from one-time revenue sources to one-time capital or operating projects.
- Applying Reserve Funds and current revenues in a ratio, which recognizes the appropriate sharing of savings from current taxpayers with contributions from future taxpayers (this will likely require repayment of all, or a portion of, Reserves from future rates or user fees).

3. Meets Statutory and Legal Requirements

Reserves must meet the requirements of the Community Charter, Federal statutes, City By-Laws or any other contract or judgment enforceable by law.

4. Meets Accounting Standards

Reserves must meet generally accepted accounting principles (GAAP) and accounting standards applicable to local governments (PSAB).

Policy Administration

The Director of Finance shall be responsible to:

- Ensure the Reserve Funds are established and maintained in compliance with this Policy.
- Conduct an annual review of the Reserve Funds and report the results to City Council.
- On an “as required basis”, recommend revisions or amendments to this Policy, due to changes in applicable statutes, accounting standards, or economy.

Administrative Criteria

1. Unique Corporate Purpose

Reserves must have a unique and specific corporate purpose. Every effort must be made to:

- Reduce complexity by combining amounts with similar purposes
- Eliminating those with redundant or outdated purposes, and
- Re-focus departmental reserves to corporate purposes and strategic plans.

2. Interest and Calculation Method

All Reserves Funds will earn interest each year. Interest will be calculated based on the audited fund balance at the end of the prior year. The interest rate used will be the determined on an annual basis.

3. Minimum and Maximum Balances

A minimum and maximum balance shall be established for each Reserve Fund. A minimum balance will ensure that each fund is not depleted to the degree that it is no longer able to serve its intended purpose. A maximum balance ensures that it does not grow beyond its intended purpose.

4. Repayment Period

A time period shall be specified for the repayment or replenishment of each Reserve Fund to its specified minimum or maximum balance.

5. Business Case Requirements

A business case shall be provided specifying the purpose, benefits and method of repayment for each proposed Departmental use of a reserve fund, except as provided by statute, City by-law or Council policy. A business case will be subject to the applicable budget, ranking or other prioritization process, and Council approval.

Reserve Funds

City of Victoria Reserve Funds are established under the authority of the Community Charter and are each supported by a bylaw that outlines the purpose and use of each fund.

A description of each of the different types of Reserve Funds covered by this policy is outlined below:

Financial Stability Reserves

Description

Financial Stability Reserves are required to ensure the ongoing financial stability and fiscal health, of all City Entities. Each reserve is funded from the year-end surplus from the appropriate entity (i.e. Operating Fund, Police Department, Water Utility, and Sewer Utility).

Guidelines for Using Funds

A Council Resolution or an Adopted Budget Bylaw is required for all appropriations from the Financial Stability Reserve Funds.

All appropriations from Financial Stability Reserves are to be considered in accordance with the following priorities.

1. Operating and Environmental Emergencies

- These appropriations are the highest priority and are based on public safety and demand nature of the expenditure.

2. Revenue Stabilization and Operating Contingency

- These appropriations are intended to stabilize the impacts of cyclical revenue downturns and operating cost increases that are largely temporary and not within the City's ability to adjust in the short-term.

3. Innovation Fund

- As an incentive to encourage creativity and innovation, appropriations may be made to fund departments and/or workgroups that would like to explore innovative and creative solutions directed towards making the Corporation more efficient and effective.
- Business cases requesting use of these funds require that the replenishment methods be specified. These would include future departmental cost or service level adjustments or additional revenue generation necessary to "top up" the accounts over a three-year period.

Description

Equipment and Infrastructure Reserves are established to create a funding source for buildings and infrastructure capital projects, new equipment purchases and capital equipment replacement programs. Currently, the city has established equipment and infrastructure reserve funds for the following purposes:

- **Police Vehicles, Equipment and Infrastructure** – This reserve is to fund the replacement and purchase of Police vehicles and equipment. This reserve is funded by annual depreciation contributions included in the Police operating budget.
- **Police Emergency Response Team Vehicles and Equipment** - This reserve is to fund the replacement and purchase of equipment for the Regional Emergency Response Team. The reserve is funded by the annual surplus from the ERT Program.
- **Victoria Conference Centre Equipment and Infrastructure** – This reserve was established to provide a source of funds to properly maintain the Conference Centre building and furnishings. This reserve is also used to fund equipment replacements and new equipment purchases. The reserve is funded by the annual surplus from the Conference Centre.
- **City Equipment** - This reserve is to fund the replacement and purchase of City equipment. This includes equipment replacement programs, computer equipment and software, office furniture, etc. This reserve is funded by annual depreciation contributions included in the City operating budget.
- **City Vehicles and Heavy Equipment** – This reserve is to fund the purchase and replacement of City vehicles and heavy equipment. This reserve is funded by annual depreciation contributions included in the City operating budget.
- **City Buildings and Infrastructure** – This reserve was established to provide a source of funds to properly maintain City Buildings and Infrastructure. This reserve is funded by annual budget contributions that are increasing by \$500,000 per year until the reserve attains an adequate funding level. This increase is subject to annual Council approval.
- **Parking Services Equipment and Infrastructure** – This reserve was established to provide a source of funds to properly maintain the City parkades. The reserve is also used to fund Parking Services equipment replacement and new equipment purchases. This reserve is funded from annual depreciation contributions included in the City's operating budget.
- **Multipurpose Equipment and Infrastructure** – This reserve was established to provide funding for equipment replacement and maintaining the Multipurpose Facility. This reserve is funded by annual depreciation contributions from the City's operating budget and RG Properties.
- **Recreation Facilities Equipment and Infrastructure** – This reserve was established to provide a source of funds to properly maintain City Recreation Facilities. The reserve is also used to fund equipment replacement and new equipment purchases for City Recreation Facilities. This reserve is funded from user fees assessed on tickets to events and facility rentals.

- **Archives Equipment** – This reserve is to fund the purchase and replacement of Archives material and equipment. The funding for this reserve comes from grants and donations.
- **Strategic Planning Initiatives** – This reserve was established to provide a source of funds to help implement Corporate Strategic Planning Initiatives.
- **Artificial Turf Field** - This reserve was established to provide a source of funds for replacement of the Finlayson field carpet and amenities and for future development of artificial turf fields. This reserve is funded from the fees collected from the rental of the Finlayson field.
- **Gas Tax** - The Governments of Canada, British Columbia and the UBCM entered into the Gas Tax Agreement on September 19, 2005. The Agreement is focused on achieving three environmental sustainability outcomes: reduced greenhouse gas emissions, cleaner water and cleaner air. The Community Works Fund provides annual contributions into this reserve.
- **Water Utility Equipment and Infrastructure** - This reserve was established to provide a source of funds to properly maintain the Water Utility Infrastructure. The reserve is also used to fund Water Utility equipment replacement and new equipment purchases. The reserve should be funded by annual budget contributions from the Water Utility.
- **Sewer Utility Equipment and Infrastructure** - This reserve was established to provide a source of funds to properly maintain the Sewer Utility Infrastructure. The reserve is also used to fund Sewer Utility equipment replacement and new equipment purchases. The reserve should be funded by annual budget contributions from the Sewer Utility.
- **Stormwater Utility Equipment and Infrastructure** - This reserve was established to provide a source of funds to properly maintain the Stormwater Utility Infrastructure. The reserve is also used to fund Stormwater Utility equipment replacement and new equipment purchases. The reserve should be funded by annual budget contributions from the Stormwater Utility.

Guidelines for Using Funds

Use of equipment and infrastructure reserves is restricted to the following types of purchases:

- Major construction, acquisition, or renovation activities as defined in the Capital Asset Policy that add value to the municipal physical assets or significantly increase their useful life. Some examples include:
 - Renovation and construction projects pertaining to new or existing city buildings,
 - Renewal, replacement, enhancement or construction of city infrastructure, sewers, storm drains, water distribution systems, buildings, roads, sidewalks, traffic systems, parks, etc.
- Vehicles and heavy equipment, individual pieces of equipment and ongoing annual equipment replacement programs as defined in the Capital Asset Policy.

Note: *A Council Resolution or an Adopted Budget Bylaw is required for all appropriations from the Reserve Funds. Further, a Council Resolution is required to create additional reserve fund categories, delete categories or shift funds between categories.*

Description

Reserves for employee benefit obligations will be established where the City is incurring a retirement benefit liability or other employee related liability, which the City is obligated to pay at some future date. Current reserves established include:

- **Police Retirement Benefits** – This reserve is to fund retirement benefits (one month's pay and vested sick leave) accrued to retiring Police officers. This reserve is funded by annual contributions included in the Police operating budget.
- **Police Employee Pension Buybacks** – Police employees are entitled to purchase additional pension service time related to their probation period, provided they were not covered by pension. The City is obligated to pay 50% of the cost once the employee retires or reaches 55 years of age. This reserve was established to fund the City's share of costs for employees purchasing pension service for probation periods. This reserve is funded by annual contributions included in the Police operating budget.
- **Police Pension Corporation Over Contributions** – This reserve was established to accumulate the City's share of Police pension over contributions. These amounts are payable to the employee upon retirement. This reserve is funded from pension contributions refunded to the City by the BC Pension Corporation.
- **City Retirement Benefits** - This reserve has been established to help fund retirement benefits (one month's pay and vested sick leave) accrued to retiring City Employees. This reserve is funded by annual contributions included in the City's operating budget.
- **City Employee Pension Buybacks** - City employees are entitled to purchase additional pension service time related to their probation period provided they were not covered by pension. The City is obligated to pay 50% of the cost once the employee retires or reaches 55 years of age. This reserve was established to fund the City's share of costs for employees purchasing pension service for probation periods. This reserve is funded by annual contributions included in the City's operating budget.
- **City Pension Corporation Over Contributions** - This reserve was established to accumulate the City's share of Firefighter pension over contributions. These amounts are payable to the employee upon retirement. This reserve is funded from pension contributions refunded to the City by the BC Pension Corporation.

Guidelines for Using Funds

Use of funds is restricted to the purpose for which each fund was established. Funds may only be accessed to supplement funding a retirement payout.

Note: *A Council Resolution or an Adopted Budget Bylaw is required for all appropriations from these Reserve Funds. Further, a Council Resolution is required to create additional reserve fund categories, delete categories or shift funds between categories.*

Economic Development

Description

The Economic Development Reserve has been established to provide a source of funds for capital projects that relate to, or help promote Economic Development within the City of Victoria. This reserve is funded from a budget contribution based on an increase in Business License fees.

Guidelines for Using Funds

These funds are available for capital projects that relate to, or help, promote Economic Development within the City of Victoria. This may include downtown revitalization projects, tourism related projects, construction projects, etc.

Note: *A Council Resolution or an Adopted Budget Bylaw is required for all appropriations from this Reserve Fund. Further, a Council Resolution is required to create additional reserve fund categories, delete categories or shift funds between categories.*

Fiscal

Description

In order for the City to maintain its Financial Health and meet future fiscal obligations, the City must establish certain fiscal reserves. Currently, the City has established the following Fiscal Reserves:

- **Debt Reduction** – This reserve was established to provide a source of funds to finance internal borrowings, local improvements and paying down the City's outstanding debt. It is currently being funded from the City's share of surpluses identified in MFA Sinking Funds and payment holidays on debt issues.
- **Reserve for Insurance Claims** – This reserve was established to provide a source of funds for liability claims not covered under our Insurance Policies.
- **Working Capital** – This reserve fund was established to ensure we meet cash flow requirements, provide contingencies for unpredictable revenue sources, and provide contingencies for emergencies (such as natural disasters). Currently there is no funding source for this reserve.

Guidelines for Using Funds

Note: *A Council Resolution or an Adopted Budget Bylaw is required for all appropriations from these Reserve Funds. Further, a Council Resolution is required to create additional reserve fund categories, delete categories or shift funds between categories.*

Development Cost Charges

Description

This reserve is required by the Community Charter to account for the proceeds from development cost charges levied against new developments. The reserve is funded from the proceeds of development cost charges levied.

Guidelines for Using Funds

Use of these funds is governed by the Development Cost Charge Bylaw and restricted to the funding approved projects as allowed by that bylaw.

Note: *An Adopted Budget Bylaw is required for all appropriations from this Reserve Fund. Further, an amendment to the Development Cost Charge Bylaw is required to create additional reserve fund categories, delete categories or shift funds between categories.*

Tax Sale Lands

Description

The Tax Sale Lands Reserve was established to account for proceeds from any sales of City land and buildings. This reserve is funded from all sales of City land and buildings.

Guidelines for Using Funds

These funds are available for building and land purchases and capital expenditures required for preparing City properties to sell (i.e. remediation, servicing, etc.)

Note: *A Council Resolution or an Adopted Budget Bylaw is required for all appropriations from this Reserve Fund. Further, a Council Resolution is required to create additional reserve fund categories, delete categories or shift funds between categories.*

Parks and Greenways Acquisition

Description

This reserve was established to provide a source of funds for purchasing Park Lands. It is currently funded from 10% of the proceeds of any City land sale.

Guidelines for Using Funds

These funds are available for purchasing park lands or lands to be developed into a park.

Note: *A Council Resolution or an Adopted Budget Bylaw is required for all appropriations from this Reserve Fund. Further, a Council Resolution is required to create additional reserve fund categories, delete categories or shift funds between categories.*

Local Amenities

Description

This reserve tracks and accounts for monies received from a developer, for public amenities related to specific developments (i.e. pathways, parks, docks, etc.). This reserve is funded from contributions by Developers.

Guidelines for Using Funds

Use of these funds is restricted to the purpose for which each contribution was based on.

Note: *A Council Resolution or an Adopted Budget Bylaw is required for all appropriations from this Reserve Fund. Further, a Council Resolution is required to create additional reserve fund categories, delete categories or shift funds between categories.*

Victoria Housing

Description

This reserve has been established to provide a source of funds to help fund housing projects including projects that fall under the Secondary Suite Incentive Program. The reserve is funded by annual contributions included in the City's Operating Budget.

Guidelines for Using Funds

Use of these funds is restricted to the funding of housing projects including those that fall under the Secondary Suite Incentive Program.

Note: *A Council Resolution or an Adopted Budget Bylaw is required for all appropriations from this Reserve Fund. Further, a Council Resolution is required to create additional reserve fund categories, delete categories or shift funds between categories.*

Dockside Affordable Housing

Description

This is a reserve that has been established to provide a source of funds to help fund affordable housing projects in Dockside. The Dockside Master Development Agreement outlines certain requirements around affordable housing that the developer has to meet. There is an option to provide cash instead of the affordable housing requirements. Those funds would be put into this reserve. In addition, the reserve is funded by 20% of the building permit fees applicable to the Dockside development.

Guidelines for Using Funds

Use of these funds is restricted to the funding of affordable housing projects in Dockside.

Note: *A Council Resolution or an Adopted Budget Bylaw is required for all appropriations from this Reserve Fund. Further, a Council Resolution is required to create additional reserve fund categories, delete categories or shift funds between categories.*

Climate Action

Description

This reserve has been established to provide a source of funds for funding climate mitigation and adaptation strategies that target energy and GHG reductions associated with facilities or transportation of either City-owned assets or Community public lands and services. This reserve is funded by the Climate Action Revenue Incentive Program (CARIP) grants.

Guidelines for Using Funds

Use of these funds is restricted to the funding of climate change initiatives.

Note: *A Council Resolution or an Adopted Budget Bylaw is required for all appropriations from this Reserve Fund. Further, a Council Resolution is required to create additional reserve fund categories, delete categories or shift funds between categories.*

Art in Public Places

Description

This reserve has been established to provide a source of funds for art in public spaces and expand opportunities for artists and members of the public to participate in the process. The Arts in Public Places policy outlines the funding formula for this reserve.

Guidelines for Using Funds

Use of these funds is restricted to the funding of art in public places initiatives.

Note: *A Council Resolution or an Adopted Budget Bylaw is required for all appropriations from this Reserve Fund. Further, a Council Resolution is required to create additional reserve fund categories, delete categories or shift funds between categories.*

Downtown Core Area Public Realm Improvements

Description

This reserve has been established to assist in funding improvements that tangibly and visibly improve the physical condition, appearance and function of the public realm within the Downtown Core Area and provide a public benefit to the overall surrounding area.

This reserve is funded by monetary contributions provided to the City of Victoria as part of the Density Bonus System described in the *Downtown Core Area Plan*. The *Downtown Core Area Plan* outlines the funding formula for this reserve.

Guidelines for Using Funds

Use of these funds is restricted to the funding of public realm improvements that support the objectives and policies of the *Downtown Core Area Plan*.

Note: *A Council Resolution or an Adopted Budget Bylaw is required for all appropriations from this Reserve Fund. Further, a Council Resolution is required to create additional reserve fund categories, delete categories or shift funds between categories.*

Description

This reserve has been established to assist in funding a portion of the cost of seismic upgrading as part of the re-use, retrofit and conservation of eligible heritage buildings within the Downtown Neighbourhood.

This reserve is funded by monetary contributions provided to the City of Victoria as part of the Density Bonus System described in the *Downtown Core Area Plan*. The *Downtown Core Area Plan* outlines the funding formula for this reserve.

Guidelines for Using Funds

Use of these funds is restricted to funding a portion of the cost of seismic upgrading of eligible heritage buildings as described in the *Downtown Core Area Plan*.

Note: *A Council Resolution or an Adopted Budget Bylaw is required for all appropriations from this Reserve Fund. Further, a Council Resolution is required to create additional reserve fund categories, delete categories or shift funds between categories.*

Appendix B – Reserve Fund Bylaw

NO. 12-016

A BYLAW OF THE CITY OF VICTORIA

The purpose of this Bylaw is to amend Schedule “A” of the RESERVE FUND BYLAW, by establishing the Downtown Core Area Public Realm Improvement Reserve Fund and the Downtown Heritage Buildings Seismic Upgrade Reserve Fund.

Under its statutory powers, including section 188 of the *Community Charter*, the Council of The Corporation of the City of Victoria enacts the following provisions:

1. This Bylaw may be cited as the “RESERVE FUND BYLAW, 2004, AMENDMENT BYLAW (2012)”.
2. Schedule “A” of Bylaw No. 04-119, the Reserve Fund Bylaw, 2004, is repealed and the Schedule “A” attached to this Bylaw is substituted for it.

READ A FIRST TIME THIS	12 th	day of	April,	2012.
READ A SECOND TIME THIS	12 th	day of	April,	2012.
READ A THIRD TIME THIS	12 th	day of	April,	2012.
ADOPTED on the	26 th	day of	April,	2012.

“ROBERT G. WOODLAND”
CORPORATE ADMINISTRATOR

“DEAN FORTIN”
MAYOR

SCHEDULE A

Column 1 – Reserve Fund	Column 2 – Reserve Fund Purpose
Parks and Greenways Acquisition Reserve Fund	For acquisition of land for parks and greenways, and acquisition and construction of improvements on that land
Tax Sale Lands Reserve Fund	For monies received from the sale of City land and buildings, for funding the purchase and development of land and improvements
Equipment and Infrastructure Reserve Fund	For funding building and infrastructure capital projects, new equipment purchases and capital equipment replacement
Financial Stability Reserve Fund	For funding operating and environmental emergencies, for stabilizing the temporary impact of cyclical revenue downturns and cost increases and for funding innovations within City Departments that create efficiencies and enhance the effectiveness of programs
Employee Benefit Obligation Reserve Fund	For funding employee retirement benefit liabilities, and other employee benefit or pension related liabilities
Economic Development Reserve Fund	For funding capital projects that promote economic development within the City
Fiscal Reserve Fund	For funding debt reduction and liability claims, and to provide a contingency for unpredictable revenue shortfalls and emergencies
Local Amenities Reserve Fund	For paying the cost of public amenities
Victoria Housing Reserve Fund	For funding housing projects, including those that fall under the Secondary Suite Incentive Program
Climate Action Reserve Fund	For funding climate action and mitigation projects that promote greenhouse gas reduction, energy conservation, and carbon neutrality
Art in Public Places Reserve Fund	For funding the planning, design, fabrication, acquisition, installation and maintenance of art in public places
Downtown Core Area Public Realm Improvement Reserve Fund	For monies received from the Density Bonus System, for funding amenities and other improvements that tangibly and visibly improve

	the physical condition, appearance and function of the public realm and provide a public benefit to the overall Downtown Core Area
Downtown Heritage Buildings Seismic Upgrade Reserve Fund	For monies received from the Density Bonus System, for funding a portion of the cost of seismic upgrading as part of the re-use, retrofit and conservation of eligible heritage buildings within the Downtown Neighbourhood

Appendix C – Community Charter Sections 188 and 189

Division 4 — Reserve Funds

Establishment of reserve funds

188 (1) A council may, by bylaw, establish a reserve fund for a specified purpose and direct that money be placed to the credit of the reserve fund.

(2) If a municipality receives money in respect of any one of the following, the council must establish a reserve fund for the applicable purpose:

- (a) money received from the imposition of a development cost charge, which must be placed to the credit of a reserve fund in accordance with section 935 *[use of development cost charges]* of the [Local Government Act](#);
- (b) money received
 - (i) from the sale of park land,
 - (ii) under section 27 (2) (b) *[disposal of park land]*, or
 - (iii) under section 941 (12) *[provision of park land on subdivision]* of the [Local Government Act](#), which must be placed to the credit of a reserve fund for the purpose of acquiring park lands;
- (c) money received under section 41 (1) (d) *[disposal of highway property that provides access to water]*, which must be placed to the credit of a reserve fund in accordance with that section;
- (d) money received under section 906 (2) *[parking space requirements]* of the [Local Government Act](#), which must be placed to the credit of a reserve fund for the purpose of providing
 - (i) off-street parking spaces, or
 - (ii) transportation infrastructure that supports walking, bicycling, public transit or other alternative forms of transportation;
- (e) except for tax sale proceeds, money received from the sale of land and improvements, which must be placed to the credit of a reserve fund for the purposes of paying any debt remaining in relation to the property and of acquiring land, improvements and other assets of a capital nature.

Use of money in reserve funds

189 (1) Subject to this section, money in a reserve fund, and interest earned on it, must be used only for the purpose for which the fund was established.

(2) If the amount to the credit of a reserve fund is greater than required for the purpose for which the fund was established, the council may, by bylaw, transfer all or part of the amount to another reserve fund.

(3) If the current municipal revenue is not sufficient for the amount required to pay compensation in respect of property expropriated or injured or to carry out works referred to in section 32 (3) [*entry on land to mitigate damage*], the council may, by bylaw, use money from a reserve fund to the extent required.

(4) As a restriction on subsection (2), a transfer from a reserve fund established for a capital purpose may only be made to another reserve fund established for a capital purpose.

(4.1) Despite any other enactment, if

(a) money in a reserve fund established for a capital purpose, including a reserve fund under section 935 of the *Local Government Act* established for a capital purpose, is not currently required for that purpose, and

(b) the municipality has another reserve fund established for a capital purpose,

the municipality may use money in the first reserve fund for the purposes of the second reserve fund.

(4.2) If money from one reserve fund is used under subsection (4.1) for the purposes of another reserve fund, the municipality must repay to the first reserve fund, no later than the time when the money is needed for the purposes of that reserve fund,

(a) the amount used, and

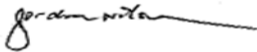
(b) an amount equivalent to the interest that would have been earned on the amount used had it remained in the first reserve fund.

(5) As a restriction on subsections (2) and (3), a council may not transfer amounts or use money from a fund required under section 188 (2) (a) [*development cost charge reserve fund*] or (b) [*park land acquisition reserve fund*] unless the bylaw is approved by the minister.

Appendix D – FCS Group Reserve Fund Review Report

To: Susanne Thompson, Director of Finance
City of Victoria

Date: March 13, 2015

From: Gordon Wilson, Project Manager 

RE: Review of Reserve Funds

A. INTRODUCTION

The City of Victoria contracted with FCS GROUP to conduct a review of the City's reserve funds and recommend changes to the City Reserve Fund Policy, which describes the funding source, eligible uses, and basis for calculating the target balance for each fund. The City has been increasing its total commitment of General Fund operating budget to reserve funding over the past decade. As total reserve balances have increased, City policymakers want to better understand the purposes and target balances of the various City reserve funds. The purpose of this memo is to discuss the function of reserve funds in general, review the City's current reserve funds, and recommend changes to the City's Reserve Fund Policy. In this discussion, we will focus on two types of questions:

- Can any of the existing reserve funds be eliminated?
- How much is enough? For a given fund, should there be a target fund balance? If so, how should it be determined?

The recommendations in this memo should be understood as suggestions or “soft recommendations,” not “hard recommendations” where there is a clear single right answer. Policies always include an element of *choice*—they reflect organizational values. They are subjective but not arbitrary. They require an effort to look ahead, to understand the effect of interrelated actions and competing objectives, and to be grounded on both reasoning and research. At several points, this memo will suggest how to approach a particular question. We do not mean to imply that there is only one reasonable answer to these questions, but we do hope to illustrate a logical way of thinking about them. Our goal in this analysis is not to eliminate the value choices but to guide them.

Our presumption throughout this memo is that the City intends to continue its Financial Sustainability Policy, which states, among other things, that debt will be incurred only for large one-time projects. This policy requires a strong emphasis on long-term capital planning and reserve funding for capital projects. This policy also contains a limit on property tax-backed debt service that currently is about \$7.8 million per year. The emphasis on accumulating reserves for capital projects helps preserve debt capacity within this cap.

The next section will explain in general terms why the City has reserve funds and what purposes those funds meet. After that, we will evaluate the current lineup of funds, making suggestions about some funds that can be eliminated and their balances transferred into another fund. Finally, we will discuss the question of target balances and how they should be determined. Except for capital funds, the “*target balance*” defines the needed funding level—any balances above the target are surplus. For capital funds, there should be a minimum balance plus fluctuating balances based on a cash flow forecast of capital requirements. This memo also contains two appendices, one with historical inflation data and the other with policy statements by the Government Finance Officers Association.

B. RESERVE FUNDS AND THEIR PURPOSES

B1. WHAT IS A FUND?

A reserve fund is, first of all, a segregated fund. In governmental accounting, a *fund* is like a separate pocket in a piece of clothing—money can be put in the pocket, taken out of the pocket, or stored in the pocket, but the money in each pocket is kept track of separately from the money in other pockets. From one fiscal year to another, the money in each fund remains in that fund, until it is taken out and either spent or moved to another pocket.

In a general purpose government such as a municipality, there are typically scores of funds, each one defined by a stated purpose. There can be groups of funds with related purposes—for example, there might be a Water Operating Fund and a Water Capital Fund, used to track different types of revenues and expenditures related to the water system. The term “subfund” means a subsidiary fund whose financial activity is aggregated into a primary fund for reporting purposes. In this example, the Water Operating and Water Capital funds could be treated as subfunds of a primary Water Fund.

The General Fund is the “everything else” fund—the largest and most flexible fund, whose resources can be used for any lawful public purpose. The General Fund can transfer money into any other fund, but funds with more narrowly defined purposes cannot transfer money into other funds unless there is an explicit relationship or overlapping purpose, or unless the transfer is part of a formal interfund loan.

Separate funds are sometimes established by the City Council not because it is legally required, but for convenience in tracking dollars that the Council intends to be restricted to a given purpose and which might require that a balance be carried forward from one year to another. In those cases, the Council can later choose to modify the fund purpose or transfer its balances into another fund. In other cases, a separate fund is legally required, often as a contractual condition of receiving a certain type of revenue, such as grants. Segregating revenue into a separate fund serves as a way to ensure that money is spent in the way intended by the source of the revenue.

There are different broad categories of funds, including operating funds or capital funds. A *reserve fund* is one of those broad categories. A reserve fund is intended primarily to hold money for a planned or potential future expenditure.

B2. WHAT RESERVE FUNDS DOES THE CITY HAVE?

For our analysis, we reviewed the purpose and status of each of the funds identified in the current City Reserve Fund Policy. The City Reserve Fund Policy, last revised on September 2, 2014, identifies 40 reserve funds used by the City. Of these, 14 primary funds or fund groups are formally established in a City Bylaw.¹ The remaining 26 funds are subfunds of those primary fund groups.

Some of the 40 reserve funds identified in the Reserve Fund Policy are further subdivided into other subfunds. For example, the Development Cost Charges (DCC) Fund separates DCC revenue and expenditures among 6 subfunds—transportation, drainage, sewage, water, park land acquisition, and park development purposes—with separate balances for each subfund. Another example is the Local Amenities Reserve Fund, which has subfunds used to track developer contributions for amenities (such as pathways, parks, or docks) related to specific developments. However, in this analysis we will focus only on those shown in the Reserve Fund Policy.

¹ 13 reserve funds are listed in *Reserve Fund Bylaw, 2004, Amendment Bylaw (2006) – No. 12-016*. Development Cost Charges (DCCs) are established through a separate *Development Cost Charge Bylaw – No. 06.65*, which cites the British Columbia Local Government Act. Section 935 of the Local Government Act requires that DCC revenue be tracked in a separate reserve fund, with subfunds for each of type of improvement to be funded by the DCC.

These funds are shown in Exhibit B-1, along with the City's classification of each fund as operating or capital, and the primary funding source. Operating funds can be used for capital purposes, but under the Community Charter, capital funds cannot be used for operating purposes. The 14 primary funds or groups of funds are shown in bold, while the subfunds are indented.

Exhibit B-1: Existing City Reserve Funds

Fund Description	City Classification	Primary Funding Source
<i>Funds recommended for elimination are in red italics.</i>		
Financial Management Reserves		
City Financial Stability Reserve *	Operating	General Fund
Police Financial Stability Reserve *	Operating	General Fund
Water Utility Financial Stability Reserve	Operating	Water rates
Sewer Utility Financial Stability Reserve	Operating	Sewer rates
Debt Reduction *	Operating	General Fund
<i>Insurance Claims</i>	Operating	No ongoing source
<i>Working Capital Fund</i>	Operating	No ongoing source
* Included in General Operating Reserves		
Equipment and Infrastructure Reserve		
Police Vehicles, Equip and Infrastructure	Capital	General Fund
Emergency Response Team Vehicles/Equip	Capital	ERT operating surplus
Victoria Conf Centre Equip and Infrastructure	Capital	VCC Surplus/General Fund
City Equipment	Capital	General Fund
Archives Equipment	Capital	Grants & donations
<i>Strategic Planning Initiatives</i>	Capital	None since 2006
City Vehicles and Heavy Equipment	Capital	General Fund
City Buildings and Infrastructure	Capital	General Fund
Parking Services Equip and Infrastructure	Capital	Charges to operating funds
Multipurpose Equipment and Infrastructure	Capital	General Fund/RG Properties
Recreation Facilities Equip & Infrastructure	Capital	User fees & Rentals
Artificial Turf Field (Topaz Park)	Capital	Field use fees
Gas Tax	Capital	Grants
Water Utility Equipment and Infrastructure	Capital	Water rates
Sewer Utility Equipment and Infrastructure	Capital	Sewer rates
Stormwater Utility Equipment and Infrastructure	Capital	Stormwater rates
Employee Benefit Obligation Reserve		
Police Retirement Benefits	Operating	Charges to operating funds
Police Employee Pension Buybacks	Operating	Charges to operating funds
Police Pension Corporation Over Contributions	Operating	Charges to operating funds
City Retirement Benefits	Operating	Charges to operating funds
City Employee Pension Buybacks	Operating	Charges to operating funds
City Pension Corporation Over Contributions	Operating	Charges to operating funds
<i>Economic Development Reserve</i>	Capital	Business license increment
Development Cost Charges Reserve	Capital	Development fees
Tax Sale Lands Reserve	Capital	Land sales
Parks and Greenways Acquisition Reserve	Capital	Land sales
Local Amenities Reserve	Capital	Development fees
Victoria Housing Reserve	Operating	General Fund
Dockside Affordable Housing Reserve	Operating	Development fees
Climate Action Reserve	Operating	Rebates
Art in Public Places Reserve	Operating	General Fund
Downtown Core Area Public Realm Improvemts.	Capital	Development fees
Heritage Buildings Seismic Upgrades Reserve	Operating	Development fees

B3. PRIMARY PURPOSES OF CITY RESERVE FUNDS

The City's reserve funds can be categorized as addressing one of four primary purposes.

1. **Dedicated Revenue** – For some of the City's reserve funds, the only purpose of the fund is to segregate the revenue and ensure that fund balances are carried forward from year to year until the money is spent on its intended purpose. The accumulation of a particular fund balance may not matter to policymakers, as long as any revenue received is kept separate until the eligible spending occurs.
2. **Planned Future Obligations** – Employee pensions and benefits create future obligations which require advance planning and reserve funding.
3. **Risk Mitigation** – Some of the City reserve funds are used to *mitigate risks* of various types, such as the risk of a revenue disruption or a sudden, compelling expenditure. For example, a healthy fiscal stability reserve can soften the economic effects of a downturn in the local economy, giving the city more time to make budget adjustments. A financial cushion does not mean that a city can entirely avoid difficult choices, but the reserve can give time for a “soft landing” in the event of a crash.
4. **Planned Capital Funding** – Many of the City reserve funds serve as a *capital funding mechanism*, because planning and saving for a capital expenditure in advance of the need is an alternative to borrowing. Like debt, building capital reserves creates a smooth pattern of expenditures over time. Unlike debt, building capital reserves allows the city to earn interest rather than paying interest, and it preserves financial flexibility.

The last two of these purposes—risk mitigation and capital funding—partly overlap. One reason is that the choice to accumulate reserves to fund capital projects also creates a cushion against risks. For example, a large reserve for a planned capital program also provides a degree of financial protection against reconstruction costs in the event of an earthquake.

In addition, whenever reserves are relied on to fund capital reinvestment in existing assets, there is always a certain amount of risk, because capital planning is never perfect and existing infrastructure can fail without warning. The less current and complete the information about City assets, the more pronounced this risk. Capital reserves can be *both* a vehicle for planned funding of known capital needs and *also* a contingency in the event of capital needs that are large, urgent, and unplanned.

C. EVALUATION OF EXISTING RESERVES

C1. COST OF MAINTAINING SEPARATE FUNDS

While the practice of segregating revenues and balances into separate funds clearly can be a useful financial management tool, its use can become excessive. There are two disadvantages worth considering in the decision to create or retain a given fund. First, a narrowly defined fund restricts the City Council's ability to express its current priorities through its funding choices. Secondly, fund accounting creates administrative costs and demands management attention. The more complex the structure of funds and accounts, the more staff time is required to ensure accurate accounting that complies with the purpose of the various funds.

Defining a fund purpose too narrowly can create a situation where the fund is effectively useless. Without periodic pruning, some funds can exist for years with small balances, infrequent activity, no ongoing revenue source, and no planned program of expenditures. With those funds whose separateness is a matter of Council policy choice (as opposed to being legally required), it is worth periodically assessing their usefulness and asking whether they should continue to exist. Otherwise, the City's accounting structure can become increasingly weighted down with dead branches.

C2. CAN ANY EXISTING FUNDS BE ELIMINATED?

Exhibit C-1 shows each of the reserves along with the 2013 balance and fund activity over the past ten years, including how many years it received revenue other than interest earnings, and how many years there was an expenditure or transfer out. The data source is accounting records provided by City staff. Based on this analysis, as well as discussions with City staff about the purpose of each fund and how it is used, we make suggestions about future use of these funds, including funds that can be eliminated. These suggested changes are shown in the rightmost column of Exhibit C-1.

Exhibit C-2 on the following two pages shows revenues and expenditures for each fund over the past ten years. The revenues exclude interest earnings. The averages in the rightmost column are the average of those years in which the fund had revenues or expenditures.

Exhibit C-1: 10-Year Historical Summary of Reserve Fund Activity (including selected subfunds)

City of Victoria Reserve Funds Summary of 10-year History	2013 Ending Balance	Average Revenue Transfer	Average Expenditure Transfer	# Years with Revenue	Most Recent Revenue	# Years with Expend	Most Recent Expend	Recommend Continued Use?
<i>Funds recommended for elimination are in red italics.</i> Note: Revenue data excludes interest earnings.								
"Financial Management Reserves" are Financial Stability and Fiscal Reserves combined.								
Financial Management Reserves:								
City Financial Stability	\$1,348,397	\$ 121,605	\$ 27,131	9	2013	1	2004	Yes
Police Financial Stability	1,250,118	496,322	371,847	2	2012	0	N/A	Yes
Water Financial Stability	-	-	-	0	Not Used	0	Not Used	Begin Using
Sewer Financial Stability	-	-	-	0	Not Used	0	Not Used	Begin Using
Debt Reduction	21,255,012	2,355,842	4,609,425	10	2013	1	2010	Yes
<i>Self Insurance</i>	3,733,373	333,333	625,000	3	2006	2	2011	Move to City Financial Stability
<i>Working Capital Fund</i>	3,837,082	-	-	0	N/A	0	N/A	Move to City Financial Stability
Equipment and Infrastructure Fund:								
Police Vehicles, Equipment and Infrastructure	1,657,651	1,122,693	1,049,665	10	2013	10	2013	Yes
Police ERT Equipment and Infrastructure	235,670	49,665	34,716	5	2012	1	2004	Only if required by agreement
VCC Equipment and Infrastructure	602,900	237,116	412,638	8	2013	8	2011	Yes
City Equipment	5,542,460	1,457,500	1,261,839	10	2013	10	2013	Yes
City Archives Equipment	47,645	4,083	-	7	2013	2	2010	Yes
<i>City Strategic Planning Initiatives</i>	141,760	45,333	16,000	3	2006	1	2006	Move to City Equip
Vehicles and Heavy Equipment	5,396,227	1,188,683	1,363,836	10	2013	10	2013	Yes
Buildings and Infrastructure	31,351,148	4,458,211	2,265,756	10	2013	10	2013	Yes
Parking Services Equipment & Infrastructure	5,612,904	271,201	165,308	8	2013	7	2013	Yes
SOFMC Equip & Infr	563,589	96,060	91,394	10	2013	5	2013	Yes
City Recreation Facilities	901,753	22,950	77,314	9	2013	3	2013	Yes
Artificial Turf Field (Topaz Park)	611,327	73,084	-	8	2013	0	N/A	Yes
Gas Tax	6,436,998	3,980,916	794,527	2	2013	2	2013	Yes
Water Utility Equipment and Infrastructure	4,900,973	1,347,179	3,491,700	7	2013	3	2009	Yes
Sewer Utility Equipment and Infrastructure	16,403,688	1,760,919	-	9	2013	0	N/A	Yes
Stormwater Utility Equipment & Infrastructure	-	-	-	0	New Fund	0	New Fund	Yes
Employee Benefit Obligations Fund:								
Employee Retirement and Sickleave Reserve	N/A	N/A	N/A	N/A	N/A	N/A	N/A	Yes
Employee Pension Buyback Reserve	N/A	N/A	N/A	N/A	N/A	N/A	N/A	Yes
Employee Pension Over Contributions	N/A	N/A	N/A	N/A	N/A	N/A	N/A	Yes
Employee Retirement and Sickleave Reserve	N/A	N/A	N/A	N/A	N/A	N/A	N/A	Yes
Employee Pension Buyback Reserve	N/A	N/A	N/A	N/A	N/A	N/A	N/A	Yes
Employee Pension Over Contributions	N/A	N/A	N/A	N/A	N/A	N/A	N/A	Yes
<i>Economic Development Fund</i>	734,445	300,000	1,525,000	5	2008	2	2008	Move to Bldgs & Infrastructure
Development Cost Charge Fund	N/A	777,122	204,298	10	2013	3	2009	Yes
Tax Sale Lands Fund	9,663,642	1,393,442	964,001	10	2013	10	2013	Yes
Parks and Greenways Acquisition Fund	2,269,464	194,554	-	8	2012	0	N/A	Yes
Local Amenities Reserve	441,917	85,443	-	5	2013	0	N/A	Yes
Victoria Housing	1,660,328	516,754	529,711	10	2013	7	2013	Yes
Dockside Affordable Housing	236,656	36,408	-	6	2011	0	N/A	Yes
Climate Action Reserve	380,950	126,275	66,493	4	2013	2	2012	Yes
Art In Public Spaces	301,565	135,000	35,971	3	2013	3	2013	Yes
Downtown Core Public Realm Improvemts	57,373	57,373	-	1	2013	0	New Fund	Yes
Heritage Building Seismic Upgrades	19,124	19,124	-	1	2013	0	New Fund	Yes

Exhibit C-2: Revenues and Expenditures for City Reserves, 2004-2013

Total Revenues excluding Interest Income											
City of Victoria Reserve Funds											Average (Non-zero Amounts)
Summary of 10-year History	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	
<i>Funds recommended for elimination are in red italics.</i>											
Financial Management Reserves are Financial Stability and Fiscal Reserves combined.											
Financial Management Reserves:											
City Financial Stability	\$ -	\$ 294,443	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 121,605
Police Financial Stability	-	25,499	-	-	-	-	-	694,318	769,150	-	496,322
Water Financial Stability	-	-	-	-	-	-	-	-	-	-	-
Sewer Financial Stability	-	-	-	-	-	-	-	-	-	-	-
Debt Reduction	164,279	138,427	784,293	2,600,601	2,501,250	656,893	3,357,702	3,935,529	1,666,851	7,752,594	2,355,842
<i>Self Insurance</i>	400,000	400,000	200,000	-	-	-	-	-	-	-	333,333
<i>Working Capital Fund</i>	-	-	-	-	-	-	-	-	-	-	-
Equipment and Infrastructure Fund:											
Police Vehicles, Equipment and Infrastructure	1,560,000	975,000	995,248	915,000	990,000	1,053,883	1,132,569	1,207,156	1,233,095	1,164,978	1,122,693
Police ERT Equipment and Infrastructure	-	115,289	(80,248)	-	-	54,783	10,193	(38,615)	53,998	14,061	49,665
VCC Equipment and Infrastructure	295,418	497,381	222,104	205,502	-	-	31,218	244,484	109,386	291,433	237,116
City Equipment	1,252,500	1,252,500	1,252,500	1,352,500	1,352,500	1,452,500	1,452,500	1,802,500	1,802,500	1,602,500	1,457,500
City Archives Equipment	-	-	-	1,683	3,778	5,230	7,775	1,719	7,295	1,100	4,083
<i>City Strategic Planning Initiatives</i>	60,000	60,000	16,000	-	-	-	-	-	-	-	45,333
Vehicles and Heavy Equipment	829,688	800,000	1,000,000	1,000,000	1,117,337	1,204,225	1,210,638	1,524,144	1,675,249	1,525,553	1,188,683
Buildings and Infrastructure	1,551,464	818,400	2,148,900	5,260,382	2,168,400	3,511,722	9,822,087	8,163,406	4,685,297	6,452,055	4,458,211
Parking Services Equipment & Infrastructure	200,000	200,000	200,000	200,000	769,611	-	(26,841)	200,000	200,000	200,000	271,201
SOFMC Equip & Infr	50,000	100,000	100,000	100,000	100,000	100,000	100,000	102,900	101,500	106,200	96,060
City Recreation Facilities	17,928	-	19,500	8,612	25,662	25,889	20,877	17,676	20,256	50,153	22,950
Artificial Turf Field (Topaz Park)	-	-	58,791	66,357	72,401	70,565	74,087	82,659	84,673	75,141	73,084
Gas Tax	-	-	-	-	-	-	-	-	5,815,067	2,146,764	3,980,916
Water Utility Equipment and Infrastructure	-	691,196	449,236	3,145,749	616,189	-	-	447,294	1,047,060	3,033,533	1,347,179
Sewer Utility Equipment and Infrastructure	-	55,754	599,650	1,339,331	1,383,424	2,264,788	1,509,083	3,232,384	2,662,775	2,801,083	1,760,919
Stormwater Utility Equipment & Infrastructure	-	-	-	-	-	-	-	-	-	-	-
Employee Benefit Obligations Fund:											
Employee Retirement and Sickleave Reserve	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Employee Pension Buyback Reserve	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Employee Pension Over Contributions	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Employee Retirement and Sickleave Reserve	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Employee Pension Buyback Reserve	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Employee Pension Over Contributions	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
<i>Economic Development Fund</i>	300,000	300,000	300,000	300,000	300,000	-	-	-	-	-	300,000
Development Cost Charge Fund	170,791	216,387	222,750	416,501	541,237	1,317,601	975,280	395,322	2,657,178	858,176	777,122
Tax Sale Lands Fund	1,188,675	6,340,840	67,884	50,000	1,179,145	1,850,000	1,426,398	950,000	770,000	111,482	1,393,442
Parks and Greenways Acquisition Fund	162,672	741,118	1,116	-	122,855	200,000	148,671	100,000	80,000	-	194,554
Local Amenities Reserve	-	-	-	-	-	49,000	306,313	24,860	17,400	29,640	85,443
Victoria Housing	250,000	250,000	250,000	250,000	597,350	2,356,000	464,193	250,000	250,000	250,000	516,754
Dockside Affordable Housing	-	-	50,457	84,761	54,597	938	27,156	540	-	-	36,408
Climate Action Reserve	-	-	-	-	-	-	187,411	89,884	103,438	124,367	126,275
Art In Public Spaces	-	-	-	-	-	-	-	135,000	135,000	135,000	135,000
Downtown Core Public Realm Improvemts	-	-	-	-	-	-	-	-	-	57,373	57,373
Heritage Building Seismic Upgrades	-	-	-	-	-	-	-	-	-	19,124	19,124

Exhibit C-2, continued

	Total Expenditures										
City of Victoria Reserve Funds											
Summary of 10-year History	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Average (Non-zero Amounts)
<i>Funds recommended for elimination are in red italics.</i>											
Financial Management Reserves are Financial Stability and Fiscal Reserves combined.											
Financial Management Reserves:											
City Financial Stability	\$ 27,131	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 27,131
Police Financial Stability	-	-	26,391	-	320,000	-	-	-	-	769,150	371,847
Water Financial Stability	-	-	-	-	-	-	-	-	-	-	-
Sewer Financial Stability	-	-	-	-	-	-	-	-	-	-	-
Debt Reduction	-	-	-	-	-	-	4,609,425	-	-	-	4,609,425
<i>Self Insurance</i>	-	-	300,000	-	-	-	-	950,000	-	-	625,000
<i>Working Capital Fund</i>	-	-	-	-	-	-	-	-	-	-	-
Equipment and Infrastructure Fund:											
Police Vehicles, Equipment and Infrastructure	958,983	682,876	1,358,063	1,196,760	1,329,389	904,024	943,262	987,851	1,208,362	927,083	1,049,665
Police ERT Equipment and Infrastructure	34,716	-	-	-	-	-	-	-	-	-	34,716
VCC Equipment and Infrastructure	143,672	281,445	758,521	173,800	609,313	1,132,688	55,703	145,961	-	-	412,638
City Equipment	569,715	1,758,661	1,237,617	1,065,155	589,323	1,297,071	1,765,060	2,080,419	1,310,741	944,630	1,261,839
City Archives Equipment	-	-	-	-	-	-	-	-	-	-	-
<i>City Strategic Planning Initiatives</i>	-	-	-	16,000	-	-	-	-	-	-	16,000
Vehicles and Heavy Equipment	313,767	786,448	2,342,749	1,399,961	468,585	1,274,711	1,991,822	883,449	2,759,554	1,417,315	1,363,836
Buildings and Infrastructure	328,410	901,194	679,873	1,222,804	2,539,450	2,752,564	2,204,774	2,720,533	2,073,580	7,234,377	2,265,756
Parking Services Equipment & Infrastructure	-	-	-	484,615	23,492	59,079	270,361	136,063	74,387	109,157	165,308
SOFMC Equip & Infr	-	-	-	-	-	12,595	51,087	13,355	253,339	126,592	91,394
City Recreation Facilities	-	-	-	-	-	40,576	97,968	-	-	93,399	77,314
Artificial Turf Field (Topaz Park)	-	-	-	-	-	-	-	-	-	-	-
Gas Tax	-	-	-	-	-	-	-	-	677,371	911,683	794,527
Water Utility Equipment and Infrastructure	-	-	-	-	-	4,308,400	2,674,999	-	-	-	3,491,700
Sewer Utility Equipment and Infrastructure	-	-	-	-	-	-	-	-	-	-	-
Stormwater Utility Equipment & Infrastructure	-	-	-	-	-	-	-	-	-	-	-
Employee Benefit Obligations Fund:											
Employee Retirement and Sickleave Reserve	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Employee Pension Buyback Reserve	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Employee Pension Over Contributions	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Employee Retirement and Sickleave Reserve	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Employee Pension Buyback Reserve	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Employee Pension Over Contributions	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
<i>Economic Development Fund</i>	-	-	-	50,000	3,000,000	-	-	-	-	-	1,525,000
Development Cost Charge Fund	609,250	75,000	-	-	-	9,857	-	50,000	277,382	-	204,298
Tax Sale Lands Fund	1,584,591	1,259,804	1,004,993	485,455	1,127,030	1,152,286	372,389	1,228,144	521,676	903,647	964,001
Parks and Greenways Acquisition Fund	-	-	-	-	-	-	-	-	-	-	-
Local Amenities Reserve	-	-	-	-	-	-	-	-	-	-	-
Victoria Housing	-	-	150,000	58,250	-	390,174	1,152,848	421,705	1,105,000	430,000	529,711
Dockside Affordable Housing	-	-	-	-	-	-	-	-	-	-	-
Climate Action Reserve	-	-	-	-	-	-	-	16,250	116,736	-	66,493
Art In Public Spaces	-	-	-	-	-	-	-	11,000	26,345	70,569	35,971
Downtown Core Public Realm Improvemnts	-	-	-	-	-	-	-	-	-	-	-
Heritage Building Seismic Upgrades	-	-	-	-	-	-	-	-	-	-	-

The following comments address individual funds or groups of funds with similar characteristics. Each fund was created by Council action at some point in the past, with some policy goal in mind at the time. For that reason, our presumption in this review is in favour of retaining any given fund unless we can see the potential for eliminating or reclassifying it without hurting the City's ability to address the underlying policy goal.

a) City Financial Stability Reserve

This is the general-purpose reserve fund for the General Fund. Because current City practice has been to transfer General Fund operating surpluses (annual revenue minus annual expenditures) either to this reserve or to the Buildings & Infrastructure Reserve after the audit each year, the City Financial Stability Reserve is not only a long-term "rainy day fund"; it also serves as the ongoing fund balance that is available to the General Fund. This fund should clearly continue to exist. The 2013 fund balance was \$1,348,397.

There are two other reserves currently listed separately that are functionally equivalent to the City Financial Stability Reserve: the Insurance Claims Fund (with a 2013 balance of 3,733,373) and the Working Capital Fund (with a 2013 balance of \$3,837,082).

The Insurance Claims Fund originated to cover legal liabilities, since the City was self-insured for liability claims until 2008, when it joined the Municipal Insurance Association. Some claims are still open, but without current activity. This fund is no longer receiving revenue (the last transfer into the fund was in 2006), and the current balance is considered by City staff to be adequate to address remaining claims. Since the payment of liability claims is a proper use of a general reserve fund, the Insurance Claims Fund can be eliminated and its balances transferred to the City Financial Stability Reserve without hurting the City's ability to address the underlying purpose of this fund.

The Working Capital Fund was established in the past, according to the existing Reserve Fund Policy, "to ensure we meet cash flow requirements, provide contingencies for unpredictable revenue sources, and provide contingencies for emergencies (such as natural disasters)." This language would be a good description of the purpose of the City Financial Stability Reserve. The Working Capital Fund has not had revenue (other than interest earnings) nor transfers out in the past ten years, and it duplicates the purpose of the City Financial Stability Reserve. For the sake of clarity about the City's financial management practices, the Working Capital Fund should be eliminated and its balances transferred to the City Financial Stability Reserve.

If the Insurance Claims Fund and Working Capital Funds are included in the City Financial Stability Reserve, the 2013 combined fund balance was \$8,918,852.

b) Police Financial Stability Reserve

This reserve has the same purpose as the City Financial Stability Reserve, but its purpose is restricted to the joint Victoria-Esquimalt Police Department. The Police Financial Stability Reserve is required by the City's agreement with the Victoria-Esquimalt Police Board, so the fund should continue to be maintained. Its target reserve is 2% of the Police operating budget. Its fund balance at the end of 2013 was \$1,250,118. That fund balance figure included a grant from the Province of about \$700,000 (relating to traffic fines), so the local-source portion of the reserve balance was just above \$500,000.

c) Water and Sewer Financial Stability Reserves

These funds are also analogous to the City Financial Stability Reserve, but they are applicable to the water and sewer utilities, respectively. While these two funds are listed in the existing Reserve Fund Policy, the funds have not actually been established in the City accounting system. Instead, utility operating surpluses at the end of each year are transferred into each utility's Equipment &

Infrastructure Fund, for use in planned capital projects. There is no year-end fund balance in the Water Operating and Sewer Operating funds.

We recommend that the Water and Sewer Financial Stability funds be created in the accounting systems and that year-end surpluses be transferred into them until they reach their target balances. The reason for these funds to exist is the same as the reason for the City Financial Stability Fund to exist—because not all sources of risk come from the capital infrastructure. There can be revenue instability or emergency demands for operating expenditures in addition to the risks associated with capital plant-in-service. For this reason it is appropriate to be prepared with either a minimum operating fund balance or a financial stability reserve that is specific to each self-sustaining enterprise. Eventually, this type of fund will also be appropriate for the new stormwater utility.

d) Debt Reduction Fund

The Debt Reduction Fund is funded by the General Fund. When past debt obligations were retired, the City began setting aside the dropoff in annual debt service requirements and transferring that amount each year to this reserve fund. The result is a growing pool of funds that can be used to avoid future indebtedness or to pay down existing debt. Most recently, funds from this reserve have been committed to serve as a source of internal borrowing for the renovation or replacement of the Crystal Pool and Fitness Centre and the Fire Hall, two major capital projects that would be difficult to undertake without external debt were it not for the availability of this reserve fund. At the end of 2013, the balance of this fund was \$21,255,012. It clearly has a current role in the City's financial administration and should be retained.

This fund is currently one of three Fiscal Reserve funds. However, this category substantially overlaps with the Financial Stability category of funds. If the City agrees with our recommendation that the other two Fiscal Reserve funds (Self Insurance and Working Capital) should be eliminated and their balances transferred to the City Financial Stability Fund, then we also suggest that the category of Fiscal Reserve Fund be eliminated and its remaining fund—the Debt Reduction Fund—be reclassified as part of a new “Financial Management Reserves” category. That reclassification is shown in Exhibit C-1. This reclassification will require a change in the Reserve Fund Bylaw.

e) Equipment and Infrastructure Funds

This group of funds is defined in the Reserve Fund Bylaw as a single “Equipment and Infrastructure Fund,” but in practical use, its various subfunds function as independent funds. These subfunds include the City's major capital funds, responsible for funding capital investment in different types of buildings, equipment, and infrastructure. The utility capital funds—one each for the water utility, sewer utility, and most recently, the planned stormwater utility—are usually reported separately from the General Fund-related funds.

In the Annual Financial Plan, some of the smaller funds in this group are reported as subfunds of another related Equipment and Infrastructure fund. For example, the Artificial Turf Field Fund balance is often combined with the City Recreation Facilities Fund, while the City Archives Equipment Fund balance is shown as part of the larger City Equipment Fund. However, the smaller funds are tracked separately in the accounting system.

Many of the General Fund-related capital funds receive funding support from the General Fund, either through an annual transfer or from charges to operating departments. Some of the General Fund-related funds do not receive General Fund revenue; instead, they receive dedicated outside revenue that is used to offset capital costs that would otherwise be borne by the General Fund. Because the City shares a police department with Esquimalt through an independent Police Board, “Police” reserves are often categorized and reported separately from “City” reserves.

The individual Equipment and Infrastructure Funds are discussed below.

Police Vehicles, Equipment and Infrastructure (Police VEI) Fund – The purpose of this reserve is to set aside money for the replacement and purchase of Police vehicles and equipment. It is funded by charges to the Police Department budget. This reserve is used routinely—ten out of the past ten years. It clearly has utility to the City. Even if this fund were not required by the agreement with the Police Board, this fund should be continued. Its ending balance in 2013 was \$1,657,651.

Police Emergency Response Team (ERT) Equipment and Infrastructure Fund – The purpose of this reserve is to fund the replacement and purchase of equipment for the Regional ERT. It is funded by the annual surplus from the ERT Program. Five times in the past ten years, most recently in 2012, the ERT Program has had surpluses that have resulted in transfers into this fund. This reserve has been used for expenditures only once in the past ten years, in 2004. Its 2013 balance was \$235,670. It is a regional fund with contributions from other municipalities, and as such must be kept separate from the Police VEI Fund. We recommend that it continue.

Victoria Conference Centre (VCC) Equipment and Infrastructure Fund – The purpose of this fund is to accumulate money for capital reinvestment in the VCC building, furnishings, and equipment. When it was established, the expectation was that it would be funded only by operating surpluses of the Conference Centre. Its 2013 fund balance was \$602,900, having received revenue from operating surpluses in eight of the past ten years. Likewise, it has been used for expenditures in eight of the past ten years. In the past year, VCC capital needs have arisen that are beyond the financial capacity of this fund, so the General Fund has committed funds to meet these needs.

This fund presents the question: why should it be separate from the Buildings & Infrastructure Fund? The reason—at least in concept—rests on the expectation of operating surpluses that would provide enough of a reserve balance to address the periodic capital needs. Segregating the operating surpluses can encourage the VCC to be more self-supporting than it would be if its capital program were a routine part of the Buildings & Infrastructure fund. The existence of a separate fund can help create a presumption of financial independence—a burden of proof for VCC representatives to meet when making funding requests.

At this point, we suggest keeping this fund separate. But the question is worth revisiting a few years from now; the fund's usefulness will depend on whether the recent need for General Fund support is an exception or a new pattern.

City Equipment Fund – This reserve is to fund the replacement and purchase of City equipment. This includes computer equipment and software, office furniture, firefighting equipment, and other equipment for most City departments. It does not include vehicles or large rolling stock—that is covered by a separate fund. The City Equipment Fund is funded by charges to departmental budgets. Its balance at the end of 2013 was \$5,558,460. This fund has been used in each of the past ten years. We recommend that it be continued.

Archives Equipment Fund – This reserve is to fund the replacement of material and equipment in the City Archives Facility. It is funded by grants or donations specific to the archive function. Its fund balance in 2013 was only \$31,534. In the Annual Financial Plan, the balance for this fund is combined with the City Equipment Fund, but in the internal accounting, it is kept separate. It has received revenue in seven of the past ten years, but it has been used for expenditures only twice during that period.

We agree that it should be kept separate from the City Equipment Fund, because of the dedicated nature of its revenue sources. However, the low visibility of this fund and relatively low fund balance creates the risk that it could be forgotten about when potential eligible expenditures arise, so the archives staff should be reminded to request funding from this dedicated revenue when funding needs arise.

City Strategic Initiatives Fund – According to the City Reserve Policy, this reserve was created to set aside funds “to help implement corporate strategic planning initiatives.” The specific initiatives are not articulated in the policy. This fund stopped receiving money (other than interest earnings) in 2006. Other than \$16,000 being transferred to the City Archives Fund in 2006, it has never been used for expenditures. In the Annual Financial Plan, this fund has been lumped together with the City Equipment Fund. Its balance at the end of 2013 was \$141,760. While it is possible that this fund was useful at some time in the past, it is clear that it has outlived its usefulness. We suggest that it be eliminated and its remaining balance transferred to the City Equipment Fund.

Vehicles and Heavy Equipment Fund – This reserve is used to fund the purchase and replacement of City vehicles and heavy equipment, such as backhoes or fire apparatus. It is funded by charges to the departments who use these assets. This fund receives revenue and incurs expenditures each year, and its 2013 year-end balance was \$5,204,227. It is clearly useful to the City and it should continue.

Buildings and Infrastructure Fund – This is the City’s largest capital reserve, with the broadest scope of responsibility. It is the “everything else” fund when it comes to funding capital reinvestment, supporting capital expenditures for roads, parks, City buildings and, in the past, storm drainage facilities. (A separate stormwater utility is planned to be established in 2016, so responsibility for storm drainage facilities will be shifted to the newly created Stormwater Utility Equipment and Infrastructure Fund.) The Buildings and Infrastructure Fund is funded by annual transfers from the General Fund, which have been increasing by \$500,000 per year in recent years. Its capital program also receives funding from the City’s capital levy and from the growth-related incremental increases in the capital levy. In addition, this fund regularly receives General Fund operating surpluses at the end of each year. Its fund balance at the end of 2013 was \$31,543,148, and it is regularly used to support capital expenditures. It is an important tool in the City’s financial management, and we recommend that it be continued.

Parking Services Equipment and Infrastructure Fund – The purpose of this fund is to support capital reinvestment in City parkades and related equipment. It is funded by annual charges to the Engineering Department, which is responsible for the parkades. The fund has received revenue in eight of the last ten years, and it has incurred expenditures in the last seven years, most recently in 2009. Its 2013 balance was \$5,612,904.

Like the VCC and the Save on Foods Memorial Centre (SOFMC), the City’s parkades are revenue-generating facilities, and the reason for segregating that revenue in a separate reserve is to be able to reinvest in the capital needs of those facilities using money generated by the facilities themselves. As evidenced by the 2013 fund balance of this reserve, the parkades have been able to generate enough revenue to build a capital reserve adequate to address future needs. This fund appears to meet its intended purpose, and we recommend that it be retained.

Multipurpose Equipment and Infrastructure Fund – “Multipurpose” refers to the Save on Foods Memorial Centre (SOFMC), which is a multi-use arena operated by RG Properties through an agreement with the City, who owns the building. Both RG Properties and the General Fund provide annual funding for this reserve, which is used for capital reinvestment in the arena and its equipment. The 2013 reserve balance was only \$563,589. Contributions come into the fund totaling \$100,000 per year, and in five of the past ten years, the fund has incurred expenditures.

A large public-private venture like an arena is clearly a situation where it is worthwhile to maintain a separate reserve fund, and we recommend that the fund continue to be used. Our concern with this reserve is not the usefulness of the fund, but the question of whether its balance is adequate to the capital needs of the facility. The SOFMC opened in 2005, and its original cost is shown on the City books as \$35.5 million, which means that after ten years, the capital reserve balance is only 2% of original cost. Like other sports and entertainment venues, arenas are subject not just to physical obsolescence but to competitive obsolescence, and renovations can be costly. Without additional

funding being set aside from the operations of the facility itself, the SOFMC could be approaching the same kind of dilemma that the Conference Centre faces now, where urgent capital improvements are proposed with a cost that far exceeds the capacity of its designated capital reserve fund.

City Recreation Facilities Fund – This fund is for capital reinvestment in City recreation facilities, supplementing capital funding that is primarily provided by the Buildings & Infrastructure Fund. This reserve is funded by user fees assessed on ticket sales and facility rentals. Its 2013 balance was \$901,753. It regularly receives about \$23,000 per year in revenue, and it has incurred expenditures in three of the past ten years. Our recommendation is that it continue to be used.

Artificial Turf Field Fund – The purpose of this fund is to provide dedicated resources toward the eventual replacement of the Finlayson artificial turf sports field at Topaz Park, as well as development of other artificial turf sports fields in the future. It is funded by field use fees. Since it started generating revenue in 2006, this fund has averaged about \$73,000 per year in fee income. Artificial turf fields typically last 15-20 years, so no expenditures have been incurred yet. The fund balance at the end of 2013 was \$611,000. In the Annual Financial Plan, this reserve is combined with the City Recreation Facilities Fund, but within the accounting system, it is tracked separately. This reserve seems to be fulfilling its purpose, and we suggest that it remain as is.

Gas Tax Fund – Unlike other funds in this Equipment and Infrastructure category, the Gas Tax Fund does not have funding responsibility for a single group of existing assets. Instead, it provides capital investments to assets for which some other fund is primarily responsible, so long as those investments further the policy purposes of the Gas Tax Agreement among the federal government, provincial government, and the Union of British Columbia Municipalities (UBCM). The policy purposes have historically included achieving reduced greenhouse gas emissions, cleaner air, and cleaner water; more recently the eligibility criteria were expanded to include recreation and tourism. The City has been receiving about \$2 million per year for a decade under this program, and starting in 2014 it will receive more than \$3 million per year. Due to changing accounting rules, this fund was classified as a reserve in 2012. Its 2013 ending fund balance was \$6,436,998. This money must legally be kept separate as a condition of receiving the grant, and we recommend that this fund continue to be used.

Water Utility Equipment and Infrastructure Fund – This is the reserve used to set aside funds for water utility capital projects. The water utility is a self-supporting enterprise, and this reserve is funded by water rate revenue. Over the past ten years, the balance in this fund has fluctuated in the way an actively used capital reserve would be expected to fluctuate. Its balance grew from \$1.9 million to \$7.2 million between 2004 and 2008. Then in 2009 and 2010, the fund balance was drawn down to \$335,000 for a major water line replacement project. Since 2010, the reserve balance has been growing again, with a 2013 ending balance of \$4,900,973. This fund should continue to be used.

Sewer Utility Equipment and Infrastructure Fund – The purpose of this reserve fund is to set aside sewer rate revenue for use in sewer capital projects. Like the water utility, the sewer utility is a self-supporting enterprise. This reserve has been gradually accumulating money since 2005, with no expenditures yet; a \$30 million sewer line replacement and rehabilitation program has been on hold, pending a decision by the regional district about the location of a wastewater treatment plant. Its 2013 ending fund balance was \$16,403,688. We recommend that this reserve continue to exist.

Stormwater Utility Equipment and Infrastructure Fund – This is the City's newest reserve fund, established to provide funding support for capital expenditures related to the planned stormwater utility. The Council has approved the creation of a stormwater utility in 2016, which means that a portion of the capital levy (\$5.1 million) will be shifted to that utility, and it will be self-funded from stormwater rate revenue from that point on.

f) Employee Benefit Obligations Fund

The purpose of this reserve is to provide advance funding for future cost liabilities related to employee pensions or other benefits. It currently has six subfunds, three for Police and three for City employees. For each group of employees, the subfunds address the same three types of liabilities:

Benefits upon Retirement – the City is obligated to pay one month of pay, plus vested sick leave, at the time of employee retirement. These Police and City subfunds set aside money for that obligation.

Pension Buybacks – At one time, employees were entitled to purchase additional pension service time related to their probation period, provided they were not covered by pension. For employees who elected to make this purchase, the City is obligated to fund 50% of the cost once the employee retires or reaches 55 years of age. These Police and City subfunds set aside money to meet that obligation.

Pension Corporation over Contributions – These two subfunds—one for police officers and one for firefighters—were established to accumulate the City’s share of employee pension over contributions, which are payable to employees upon retirement.

The first two types of subfunds are paid for by charges to the relevant department budgets. The “Pension Corporation over Contributions” subfunds are paid for by pension contributions refunded to the City by the BC Pension Corporation.

The internal accounting reports we reviewed did not contain fund balance data for these funds. (This is because for technical accounting reasons, these funds are treated as a liability on the City balance sheet rather than an accumulated surplus.) However, the Public Section Accounting Board requires the City to maintain these reserves, and they should be retained.

g) Economic Development Fund

At the time of a previous increase in business license fees, the City made a policy commitment to use the incremental revenue for capital projects associated with economic development. The Economic Development Reserve fund was established to keep that incremental revenue separate and ensure that it was used for its intended purpose. Since the time when this reserve was created, the entire annual funding stream from the business license increment has been committed to service debt incurred for economic development-related projects. As a result, since 2008 there has been no additional revenue generated to add to the fund balance. The question has been what to do with the remaining balance—about \$735,000 at the end of 2013. Our suggestion is that since the Victoria Conference Centre capital renovations have been budgeted beginning in 2014 for amounts exceeding \$735,000, this fund can be closed and its remaining balances transferred to the Buildings and Infrastructure Fund. The VCC project clearly qualifies as an economic development-related capital project, so the policy commitment that was made at the time the business license fee was increased has been met. Since this is a primary fund mentioned in the Reserve Funds Bylaw, a change in the Bylaw will be necessary in order to close this fund.

h) Development Cost Charge Fund

This fund is used to set aside revenue from development cost charges (DCCs), as required by provincial statute. DCCs are imposed as a condition of development, and this reserve ensures that the money is only spent on public capital improvements related to the type of infrastructure for which the DCC is imposed. There is a DCC (and a subfund) for transportation, water, drainage, sewage, park land acquisition, and park improvements, but they are rolled up into a combined fund amount in the Annual Financial Plan’s yearly report on the status of reserve funds. Because the fund balances are treated as a liability on the balance sheet, the historical analysis we reviewed did not contain fund balance data for the DCC Fund. However, this fund is legally required and should be continued.

i) Tax Sale Lands Fund

This fund segregates the proceeds from the sale of City-owned land and buildings. It can be used for the purchase and development of land and improvements, including environmental remediation. Its 2013 fund balance was \$9,663,642. It is routinely used, with revenues and expenditures every year for the past ten years. We recommend that it be retained.

j) Parks and Greenways Acquisition Fund

This fund is for acquisition of land for parks and greenways, and it is funded by 10% of the proceeds from the sale of City lands. Even though there is some degree of overlap between this function and that of the Tax Sale Lands Fund, this one has a more specific focus, and by legislation the two funds are kept separate. The Parks and Greenways Acquisition Fund has received revenue in eight of the past ten years, but it has not been drawn on in the past ten years. Its 2013 fund balance was \$2,269,464. Because the key requirement in a park land acquisition program is an acquisition strategy, with acquisition criteria and a prioritized list of target properties or park-deficient neighborhoods, the fact that this fund has not been drawn on in ten years indicates that if such a strategy exists, it is not being pursued actively.

For both this fund and the Tax Sale Lands Fund, the fund balances are high enough to justify creating or updating a formal acquisition strategy, so the City can pursue its acquisition goals deliberately rather than on an ad hoc basis. Property acquisition is inevitably an opportunity-driven business, so unless the City has clear criteria and discipline in following them, it would be easy to end up making a series of poorly coordinated choices. Even though this fund has not been used for the past ten years, we suggest that it be retained, and that steps be taken to address its purpose.

k) Local Amenities Fund

The purpose of this fund (and its subfunds) is to segregate developer contributions toward specific capital improvements related to a particular development. These amenities could be parks, pathways, special sidewalks or street lighting, docks, etc.—assets that would be publicly owned but whose primary benefit is to a particular neighborhood. This fund began receiving revenue in 2009; it has not yet been drawn on for any capital improvements. Its use will be subject to individual amenity contribution agreements. The revenue in one year was \$306,000, but the revenue in the other four years ranges from \$17,000 to \$49,000, which suggests that the individual amenity contributions might be so small as to present a challenge to spend the money in a meaningful way. The aggregate fund balance was \$441,917 at the end of 2013. Because this fund is so new, it should be continued for now. Time will be required to see if this approach is very useful in addressing the City's goals.

l) Victoria Housing Fund

This fund is used to segregate money committed by the City for housing purposes. It is used to provide grants for housing projects, including projects that fall under the Secondary Suites Incentive Program. It is funded by an annual General Fund transfer which in recent years has been \$250,000 per year. Its 2013 balance was \$1,660,328. This fund is classified as an operating fund because it is used for grants to private parties, so its expenditures do not result in a City-owned asset. However, housing is part of the built environment of a community, and the underlying purpose of this fund is very similar to that of a capital fund. This fund has made grants in seven of the past ten years, which indicates that it is meeting its purpose as a segregated fund, and we recommend that it be retained.

m) Dockside Affordable Housing

This fund is designed to provide a source of funds for affordable housing projects in the Dockside neighborhood. The Dockside Master Development Agreement required of the developer either a cash payment or affordable housing set-asides. The cash payments are kept in this reserve, along with 20% of fees from Dockside building permits. The fund must be used for affordable housing projects in Dockside. This fund received a modest amount of money each year from 2007 through 2011 (as little as \$500 and as much as \$85,000 in a given year), and its balance stands at \$236,656 as of the end of 2013. During the eight years since its creation, the fund has not expended any money. We suggest retaining this fund, particularly since it is the subject of a Master Development Agreement. However, given how specific the purpose is, and how small the revenue stream is compared with the magnitude of the policy need, it could be a challenge to spend the money in a way that is meaningful.

n) Recently Established Funds

Four narrowly focused reserve funds have been created in the past four years. Because of their relatively recent vintage, it is too soon to evaluate their usefulness as segregated reserves, and we recommend that they all continue for the time being. These funds are the following:

Climate Action Fund – To pay for strategies or improvements to reduce energy and greenhouse gas emissions. Funded by rebates and grants. 2013 balance: \$380,950.

Art in Public Places Fund – To pay for art in public spaces, funded by the General Fund, following a funding formula established when the fund was created. 2013 balance: \$301,565.

Downtown Core Area Public Realm Improvements Fund – For Downtown improvements, funded by density bonus system described in *Downtown Core Area Plan*. 2013 balance: \$57,373.

Heritage Buildings Seismic Upgrades Fund – to pay part of cost of seismic upgrades to heritage buildings, funded by density bonus system in *Downtown Core Area Plan*. 2013 balance: \$19,124.

D. TARGET BALANCES - HOW MUCH IS ENOUGH?

D1. INTRODUCTION TO TARGET BALANCES

We noted previously the four primary purposes of the City's reserve funds:

- To ensure that dedicated revenue is used only for its specified purpose;
- To set aside money in advance for planned future obligations to employees;
- To mitigate risk by setting aside money for significant, unexpected costs or revenue losses; and
- To set aside money in advance for planned capital projects.

These four purposes of the City's reserve funds are the main consideration when addressing the question, "How much is enough?" Whether a given fund should have a target balance and, if so, how it should be determined, depends primarily on what the fund's purpose is to the City.

a) Dedicated Revenue Reserves

For reserve funds whose only purpose is to keep a dedicated revenue stream separate until eligible expenditures occur, there logically is no target balance. For example, with the Local Amenities Reserve it would not make sense to aim for a particular minimum balance, because the revenue entirely depends on whether development occurs in a certain area, something the City does not control. There is also no need to aim for a particular maximum balance—because this fund receives no General Fund support, there are no competing Council priorities that could be funded if this reserve had surplus balances.

b) Employee Benefit/Pension Reserves (Planned Future Obligations)

For pensions and other future obligations to employees, the appropriate target balance should be defined through actuarial analysis. If the pension and benefit reserve funding exceeds its target level, any excesses can be returned to the operating funds in proportion to their labor charges. Our understanding is that the City already has actuarial estimates of the required reserves for these funds.

c) Risk Reserves

A risk reserve consists of money that is not planned to be spent, but which could be needed in unforeseen and urgent circumstances. A risk reserve should have a defined target balance. If the current balance is less than the target, the City should take action to replenish the reserve over some number of years. If the current balance is above the target, the reserve can be drawn down, or at the very least its interest earnings can be transferred to its related operating fund.

d) Capital Reserves (Capital Contingency plus Planned Capital Funding)

Several of the subfunds within the Equipment and Infrastructure fund consist of relatively large, actively used reserves that are relied on for capital investment in both existing and new assets. In general, any reserves that are relied on to fund capital reinvestment in existing assets ("major capital reserves") should have a minimum "capital contingency" to provide cash in the event of capital needs that are large, urgent, and unplanned. The target reserve balance will consist of this minimum capital contingency plus the funding required to meet the cash requirements of the planned capital program.

In addition, two capital reserve funds exist for the purpose of property acquisition—the Tax Sale Lands Fund and the Parks and Greenways Acquisition Fund. Since these funds are not responsible for a group of existing assets, they need not maintain a capital contingency, but they should have a target fund balance that is based on a formal property acquisition strategy.

D2. RECOMMENDED TARGET BALANCES

Exhibit D-1 summarizes the City's current reserve funds, including their purpose and our suggested basis for calculating their target balance.

Exhibit D-1: Purpose of Reserves and Suggested Basis for Target Balance

Fund Description	Primary Purpose of Reserve	Planned Spending?	Target Balance?	Recommended Basis for Target Balance
<i>Funds recommended for elimination are in red italics.</i>				
Financial Management Reserves				
City Financial Stability Reserve *	Risk mitigation	No	Yes	Combined target for General Operating Reserves *
Police Financial Stability Reserve *	Risk mitigation	No	Yes	2% of operating expenses, per agreement *
Water Utility Financial Stability Reserve	Risk mitigation	No	Yes	60 days (16.67%) of operating expenses
Sewer Utility Financial Stability Reserve	Risk mitigation	No	Yes	60 days (16.67%) of operating expenses
Debt Reduction *	Risk mitigation	No	Yes	Combined target for General Operating Reserves *
<i>Insurance Claims</i>	Risk mitigation	No	Yes	Move to City Financial Stability
<i>Working Capital Fund</i>	Risk mitigation	No	Yes	Move to City Financial Stability
* Included in General Operating Reserves				* Target for combined General Operating Reserves is at least 60 days (16.67%) of General Operating expenses
Equipment and Infrastructure Reserve				
Police Vehicles, Equip and Infrastructure	Planned capital funding	Yes	Yes	Minimum 0.3% of replacement cost, plus funding of replacement schedule, subject to agreement
Emergency Response Team Vehicles/Equip	Dedicated Revenue Source	No	No	No target balance unless required by agreement
City Equipment	Planned capital funding	Yes	Yes	Minimum 0.3% of replacement cost, plus funding of replacement schedule
Archives Equipment	Dedicated Revenue Source	No	No	No target balance
<i>Strategic Planning Initiatives</i>	Dedicated Revenue Source	No	No	Move to City Equipment Fund
City Vehicles and Heavy Equipment	Planned capital funding	Yes	Yes	Minimum 0.3% of replacement cost, plus funding of replacement schedule
Victoria Conf Centre Equip and Infrastructure	Planned capital funding	Yes	Yes	Minimum 0.5% of replacement cost, plus funding of capital program
City Buildings and Infrastructure	Planned capital funding	Yes	Yes	Minimum 0.7% of replacement cost, plus funding of capital program
Parking Services Equip and Infrastructure	Planned capital funding	Yes	Yes	Minimum 0.3% of replacement cost, plus funding of capital program
Multipurpose Equipment and Infrastructure	Planned capital funding	Yes	Yes	Minimum 0.5% of replacement cost, plus funding of capital program
Recreation Facilities Equip & Infrastructure	Dedicated Revenue Source	Yes	Yes	Minimum 0.5% of replacement cost, plus funding of capital program
Artificial Turf Field (Topaz Park)	Dedicated Revenue Source	Yes	No	No target balance
Gas Tax	Dedicated Revenue Source	Yes	No	No target balance
Water Utility Equipment and Infrastructure	Planned capital funding	Yes	Yes	Minimum 0.3% of replacement cost, plus funding of capital program
Sewer Utility Equipment and Infrastructure	Planned capital funding	Yes	Yes	Minimum 0.3% of replacement cost, plus funding of capital program
Stormwater Utility Equipment and Infrastructure	Planned capital funding	Yes	Yes	Minimum 0.3% of replacement cost, plus funding of capital program
Employee Benefit Obligation Reserve				
Police Retirement Benefits	Planned Future Obligations	Yes	Yes	As determined by actuarial analysis
Police Employee Pension Buybacks	Planned Future Obligations	Yes	Yes	As determined by actuarial analysis
Police Pension Corporation Over Contributions	Planned Future Obligations	Yes	Yes	As determined by actuarial analysis
City Retirement Benefits	Planned Future Obligations	Yes	Yes	As determined by actuarial analysis
City Employee Pension Buybacks	Planned Future Obligations	Yes	Yes	As determined by actuarial analysis
City Pension Corporation Over Contributions	Planned Future Obligations	Yes	Yes	As determined by actuarial analysis
<i>Economic Development Reserve</i>	Dedicated Revenue Source	No	No	Move to Bldgs & Infrastructure Fund
Development Cost Charges Reserve	Dedicated Revenue Source	No	No	No target balance
Tax Sale Lands Reserve	Planned capital funding	Yes	Yes	Based on acquisition strategy
Parks and Greenways Acquisition Reserve	Planned capital funding	Yes	Yes	Estimated cost of 1.5 hectares land
Local Amenities Reserve	Dedicated Revenue Source	No	No	No target balance
Victoria Housing Reserve	Dedicated Revenue Source	No	No	No target balance
Dockside Affordable Housing Reserve	Dedicated Revenue Source	No	No	No target balance
Climate Action Reserve	Dedicated Revenue Source	No	No	No target balance
Art in Public Places Reserve	Dedicated Revenue Source	No	No	No target balance
Downtown Core Area Public Realm Improvemts.	Dedicated Revenue Source	No	No	No target balance
Heritage Buildings Seismic Upgrades Reserve	Dedicated Revenue Source	No	No	No target balance

The following two sections provide a more in-depth discussion of how we arrived at our recommended basis for target balances. First, we will address risk reserves, then capital reserves.

To summarize in advance: risk reserves should have a target balance that is expressed as a percentage of operating expenses. The capital reserves are of two types: major capital reserves (responsible for a group of existing assets) and property acquisition reserves. The major capital reserves should have a minimum capital contingency plus funding to meet the cash requirements of their capital improvement programs. The two property acquisition funds should have target balances based on an adopted acquisition strategy and the types of properties intended to be acquired.

E. TARGET BALANCES FOR RISK RESERVES

For the City of Victoria, the risk reserves are comprised of what we suggest be called the “Financial Management Reserves”—the combination of the various Financial Stability Reserve funds and what has in the past been referred to as the Fiscal Reserve funds. Two of the Fiscal Reserve funds are so similar in purpose to the City Financial Stability Fund that we recommend that the three funds be combined. In the rest of this discussion of target balances, we will assume that our recommendations about combining and reclassifying the Financial Management Reserves are accepted by the City.

Within the Financial Management Funds, two of them are related to self-supporting enterprises, the water utility and the sewer utility. These funds have been defined in the Reserve Fund Policy but not actually established yet; we recommend that they be created and used. As we explain below, until these funds are fully funded at their target level, we suggest that not less than 50% of the year-end surplus each year be transferred to each utility’s risk reserve. Eventually, as the stormwater utility is formed and begins to generate revenue from stormwater rates, we recommend that a Stormwater Financial Stability Fund be created and funded as well.

The reserves not associated with self-supporting utilities are “General Operating Reserves”—reserves that are related to General Fund functions. Assuming that the City Financial Stability Fund is combined as recommended, there will be three General Operating Reserves: the City Financial Stability Fund, Police Financial Stability Fund, and the Debt Reduction Fund. The Police Financial Stability Fund has its own target reserve balance specified by the agreement with the Victoria-Esquimalt Police Board, which is 2% of the Police operating budget. At the same time, its reserve fund balance is included in the calculation of the combined target balance for the General Operating Reserves.

Because risk reserves exist to protect against the broadest set of unknown circumstances, their target balances are unrelated to the amount of current infrastructure or a capital program. Instead, target balances for risk reserves are typically expressed as a percentage of either the total operating revenue or total operating expenses of the related operating fund. In this analysis we have chosen to characterize them with reference to operating expenses or the operating budget.

E1. GFOA BEST PRACTICES – GENERAL OPERATING RESERVES

The Governmental Finance Officers Association (GFOA), the professional association serving local government finance officials in Canada and the United States, has prepared statements of “best practices” to guide local governments in developing their policies and standards. Like this memo, the best practice statements are “soft recommendations”—they acknowledge the variety of local circumstances that local governments can face. However, they are a useful benchmark to consult when developing financial policies.

Three of the best practice statements are relevant to the establishment of a target balance for Victoria’s risk reserves: “Determining the Appropriate Level of Unrestricted Fund Balance in the General Fund” (October 2009); “Replenishing Fund Balance” (February 2009); and “Determining the Appropriate Levels of Working Capital in Enterprise Funds” (February 2011). The full statements are included in Appendix B at the end of this memo.

a) Target Balance for General Operating Reserves

With respect to the unrestricted balance in the General Fund, the GFOA Best Practice Statement says that “GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.”

Should Victoria’s General Operating Reserves exceed the minimum recommended by GFOA? Our recommended answer is “no.” In arriving at the two month guideline (which is equivalent to about 16.67%), the GFOA was considering the full range of contingencies that could become the responsibility of the General Fund, including capital contingencies. However, Victoria’s emphasis on building capital reserves in lieu of incurring debt already creates a cushion for capital contingencies. Another type of contingency that is assumed in the GFOA guideline is a sharp drop in revenues. However, Victoria’s revenue structure is relatively stable, relying primarily on property taxes. In the 2014 Annual Financial Plan, estimated property tax income was \$116.2 million, or 79% of the General Fund operating budget (\$146.6 million). Since the risk of revenue volatility is relatively low and the risk of unforeseen capital demands is largely addressed by capital reserves, the general risk profile for Victoria should be considered lower than that of the typical GFOA local government, and the two-month guideline for General Operating Reserves should be adequate.

Exhibit E-1 shows how the GFOA guideline might be applied to the City of Victoria.

Exhibit E-1: Method of Calculating Target Balance for City Financial Stability Reserve

Calculation of City Financial Reserve Target Balance			
General Fund 2014 Operating Budget	\$	146,587,162	
Combined General Operating Reserve Target	\$	24,500,000	
<i>(60 days of General Fund Budgeted Operating Expenses, rounded up)</i>			
Less Other General Operating Reserves (2013 ending balance):			
Debt Reduction Reserve		21,255,012	
Police Financial Stability Reserve		1,250,118	
Total Other General Reserves		22,505,130	
Minimum Reserve for City Financial Stability Fund Alone	\$	1,994,870	
<i>Comparison of Target with Actual 2013 Ending Balances:</i>			
Existing City Financial Stability Reserve	\$	1,348,397	
Insurance Claims Reserve		3,733,373	
Working Capital Reserve		3,837,082	
Combined City Financial Stability Reserve		8,918,852	
Debt Reduction Reserve		21,255,012	
Police Financial Stability Reserve		1,250,118	
Total General Operating Reserves, Year-end 2013		31,423,982	
Target Balance, Combined General Operating Reserves		24,500,000	
Actual above Target, 2013	\$	6,923,982	
<i>Implications for Debt Reduction Fund:</i>			
Balance that could be spent on retirement of outstanding debt	\$	6,923,982	
Balance that should be retained or used for interfund loans only		15,581,148	
Total Debt Reduction Fund 2013 ending balance	\$	22,505,130	

In Victoria, the sum of the General Operating Reserves is equivalent to the “General Fund unrestricted ending fund balance” referred to in the GFOA guideline. (One might argue that General Capital Reserves should also be included. However, because the Community Charter forbids using capital reserves for operating purposes, general capital reserves are not as flexible in addressing the full range of fiscal needs, so we excluded them to be conservative.) The General Operating Reserve target balance is 60 days of operating expenses, rounded up to \$24.5 million. The actual 2013 balance for these reserves were about \$31.4 million, \$6.9 million above target. This means that \$6.9 million of the Debt Reduction Fund could be used to retire debt without causing the City to drop below target. The other \$15.6 million in that fund should be retained or used only for interfund loans.

b) Required Police Operating Reserve

Separate from the policy target for General Operating Reserves, the agreement between the City of Victoria and the Victoria-Esquimalt Police Board requires that the City maintain a Police Operating Reserve equal to 2% of the Police operating budget. Exhibit E-2 shows that based on the 2014 Annual Financial Plan, this requirement equates to a minimum reserve balance of about \$940,000.

Exhibit E-2: Required Police Operating Reserve

Police Operating Reserve Required by Agreement with Police Board	
2014 Police Operating Budget per Annual Financial Plan	\$ 46,946,125
Target Reserve per Agreement (2%, rounded up)	\$ 940,000

c) Replenishing General Operating Reserves

The Best Practices Statement on Replenishing Fund Balances recommends that the reserve fund policy include a statement outlining the approach to replenishment, including the time frame within which reserves will be expected to be replenished after having been used. The suggested time frame for replenishment is from one to three years, though extenuating economic circumstances might lead a government to replenish reserves over a longer time frame. For the Victoria reserve policy, we suggest that language be added stating that whenever the General Operating Reserve is brought below the target level, that a replenishment strategy shall be required to be developed and incorporated into the action of drawing down the reserve. The policy should state that under normal circumstances, the General Operating Reserve shall return to its target balance within three years.

There may be some circumstances in which a three-year replenishment cannot be assured or may not be reasonable. For example, the reason for a general reserve draw could be a significant economic slump, where General Fund revenues are expected to eventually recover but the bottom of the economic cycle is unknown. Alternatively, one can conceive of a scenario where a change in provincial law causes a revenue disruption that is expected to be permanent, and which is so severe that the City Council decides to create a “soft landing” for the General Fund operating budget by drawing down the General Operating Reserves over a three-year period of time. In that scenario, where the reduced level of revenues is a permanent change, and operating budgets have been cut severely over a three-year period, it would take a strong policy commitment to begin rebuilding the reserves over even a five-year period of time, much less a three-year period.

One way to make the replenishment process less onerous to the General Fund operating budget process is to rely on annual operating surpluses, which typically occur each year as departments underspend their operating budget. The underexpenditure in the operating budget, plus the overachievement of budgeted revenues (net of the underachievement of budgeted revenues), typically creates a one-time resource each year. Because it is one-time and the magnitude cannot be predicted in advance, prudent budgeting practices call for these surpluses to be used for some non-recurring purpose, which can include capital projects or the accumulation of needed reserves. Currently, the City uses its operating surpluses on one-time expenditures or transfers it into the Buildings and Infrastructure Fund. However, during a period when actual reserves are below the target level, annual operating surpluses should first be committed to reserve replenishment.

If the circumstances are such that a multi-year reserve drawdown appears likely, then the policy requirement for a replenishment plan could also include a requirement for a graduated drawdown. For instance, the drawdown plan could stipulate that the first-year draw could be no more than 50% of available reserves, the second-year draw could be no more than 50% of the remainder, and the third-year draw could be no more than 50% of the remainder, and after three years the replenishment process would have to begin.

A drawdown plan or extended-period replenishment plan that depends on operating surpluses should be for the most extraordinary circumstances, where a severe loss is expected to continue over a multi-year period. If the loss is of a one-time nature—for instance, a major wildfire or a one-time legal judgment against the City—then a scheduled three-year replenishment should be within reach.

In summary, we recommend that the revised Reserve Policy state that a replenishment plan (along with a drawdown plan if the loss is of a multi-year nature) be adopted at the same time as the decision to reduce General Operating Reserves below their target balance, and that under normal circumstances, reserves should be replenished within three years after the drawdown is completed.

d) Recommended Utility Operating Reserves

The GFOA Best Practices statement for enterprise funds such as the water or sewer utilities states that “under no circumstances should the target for working capital be less than forty-five (45) days worth of annual operating expenses and other working capital needs of the enterprise fund.”

Should Victoria’s water and sewer operating reserves exceed the minimum recommended by GFOA? Our recommended answer is “yes.” A typical standard operating reserve within the utility industry is 45 days of operating expenses for sewer and 60 days for water. The reason a water utility usually has a higher minimum operating balance than a sewer utility is that most water utilities are more dependent on water consumption as a factor in their rate revenue, whereas sewer utilities often have a flat monthly charge, particularly for single family residential customers. A riskier revenue stream translates into a higher minimum operating reserve balance. In the case of Victoria, both the water and sewer revenue have substantial dependence on metered water consumption. We suggested a 60-day operating reserve for both water and sewer utilities. Exhibit E-3 shows that this equates to \$2.2 million for water and \$600,000 for sewer.

Exhibit E-3: Target Balance for Utility Operating Reserves

	Water	Sewer
2014 Operating Budget per Annual Financial Plan	\$ 12,921,850	\$ 3,321,930
Target Reserve (60 days, rounded up)	2,200,000	600,000

We have not seen specific plans for the new stormwater utility, but most stormwater rates are based on some kind of measurement—such as impervious surface area—that is a more-or-less permanent characteristic of a given parcel. For that reason, stormwater revenue is usually the most stable of all the local utility revenue, and a 45-day operating reserve should be adequate for it.

At present the Victoria water and sewer utilities have no operating reserves at all, so establishing them will require a funding commitment. We suggest the same procedure we described above for replenishing General Operating Reserves: rely on annual operating surpluses.

The current Victoria Reserve Fund policy states that the Financial Stability Reserves are “funded from the year-end surplus from the appropriate entity (i.e., Operating Fund, Police Department, Water Utility, and Sewer Utility).” In actual practice, though, water and sewer year-end surpluses have been routinely swept into the related capital fund. Our suggestion is that until the Water and Sewer (and eventually Stormwater) operating reserves are fully funded at the target level, at least 50% of operating surpluses should go first toward funding the reserve.

In relying on operating surpluses to fund the operating reserves, it might take several years to arrive at the recommended operating reserve fund level, but the City will be moving steadily in the right direction. With either utility, it is possible that there would be a rate impact from requiring an operating reserve to be established and funded, because operating surpluses currently committed to capital expenditures would instead be used to build reserve balance. But even if it requires some degree of sacrifice from current ratepayers, we recommend it as a good financial practice.

F. TARGET BALANCE FOR CAPITAL RESERVES

There are two components of the target balance for the capital reserve: the minimum balance, or “capital contingency” and the cash requirement needed to fund planned capital projects. They are discussed in turn.

F1. CAPITAL CONTINGENCY (MINIMUM RESERVE BALANCE FOR MAJOR CAPITAL FUNDS)

a) How is the Capital Contingency Used?

The capital contingency is the bottom layer of the capital reserve fund balance—the money that is never expected to be actually used. If it is too high, then there is a risk that an unreasonably large amount of resources would be functionally useless. If it is too low, then there is a risk that an emergency capital need could create a disruptive financial demand on the rest of the system.

Because of Victoria’s emphasis on advance funding of capital needs (rather than debt), the capital contingency needn’t be exceptionally large, because the top layer of these reserve funds—the part that is usable for planned capital funding—also plays a “shock absorber” role in the funding of a capital system. For example, if a water system has a capital contingency of \$800,000, with another \$4.1 million saved up for planned future capital projects, then what happens if an emergency capital project costing \$1.2 million arises? Two things will happen. First, the City can dip below its normal minimum balance of \$800,000 to the degree necessary to address the urgent capital need. Second, the planned capital program will be re-evaluated, to see which projects can be delayed because the emergency project has now taken its place first in line. The second option would not be as readily available to another city that had less of a commitment to advance funding for its capital programs. (There is also a third option—borrowing. Of course, one of the purposes of a capital contingency is to minimize the risk of having to borrow. But borrowing is an option, and the fact that the City is so reluctant to borrow is part of what preserves its flexibility to do so when circumstances are most urgent.)

An “emergency capital need” is not limited to situations where some piece of existing infrastructure fails. It can also occur when unexpected conditions cause cost overruns with a previously planned capital project. It can also occur as a result of a time-sensitive opportunity—“if we spend money now, we will save money down the road.” The key attribute of these situations is that they require a timely and unexpected commitment of funds. Those are the conditions under which having a capital contingency, appropriately sized, can help the City avoid debt and also avoid disruptive impacts to current taxpayers or ratepayers.

b) Basis for the Capital Contingency

The utility industry has a long history of planning for both capital programs and capital contingencies, and it can provide a useful starting point in developing target capital contingencies for other types of assets as well, including streets and buildings.

There are two ways to develop a capital contingency amount. One approach is to estimate the replacement cost of an expensive single asset that could fail suddenly, and use that specific risk as a benchmark for how much to set aside for unplanned capital costs. Another, more typical way is to estimate the total magnitude of the capital infrastructure for which a given fund is responsible, and then choose a percentage of the cost of those assets.

c) Replacement Cost of an Expensive Asset

In the utility business, one way to help choose a capital contingency is to focus on a particularly expensive single asset that could be subject to sudden failure, and then set aside the estimated replacement cost of that asset. For example, a water utility might use the cost of replacing a major water line, or a road system might use the cost of replacing a particular bridge. The disadvantage of this method is that it focuses exclusively on one representative asset, without taking into account the overall magnitude of the assets for which a given reserve might be needed. It also places inordinate emphasis on asset failure as the thing that could warrant use of the capital contingency, when in fact the capital contingency could be drawn on for other reasons as well, such as overruns in the cost of planned capital projects.

However, even if the City decides to use the other method—a percentage of total asset cost—to choose its capital contingency, it is still helpful to use the cost of replacing a particular expensive asset as a “reasonableness check.” For example, if the “percentage of asset cost” method for the sewer utility results in a capital contingency of \$1 million, the City could check the reasonableness of that reserve threshold by asking how much it might cost to replace a major lift station, or how much in cost overruns it might be suddenly responsible for in the construction of a regional treatment plant.

d) Percentage of Asset Cost

Within the utility industry, the most common way to set a capital contingency is to focus on a percentage of asset cost, with a typical rule-of-thumb being 1% of the original cost of assets. While replacement cost is a more accurate way to measure the financial impact of potential asset failure, for most utilities the advantage of using original cost is simply that the data is more likely to be available and routinely updated for the full range of assets. Over time and with many utilities, 1% of original cost has been a simple way to define a capital contingency that is useful but not excessive.

Replacement Cost vs. Original Cost – However, for very old assets, using “original cost” as a benchmark for asset value can be problematic, because inflation over time increases the difference between original cost and current replacement cost. Exhibit F-1 shows the relationship between original cost and current replacement cost, using data from the Engineering News-Record (ENR) Construction Cost Index from 1914 through 2014. We can see that due to inflation, a building that was constructed in 1914 for \$10,000 would be expected to cost approximately \$1,101,900 in 2014. (A complete table showing all of the ENR Construction Cost Index values from 1908 through 2014 is shown in Appendix A.)

Exhibit F-1: Relationship Between Original Cost and Replacement Cost

Engineering News Record (ENR) 20 City Average Construction Cost Index (CCI)				
Year	ENR CCI (yearly avg)	Age (years)	Current Cost as Multiple of Original Cost	Original Cost as Percentage of Current Cost
1914	89	100	110.19	1%
1924	215	90	45.61	2%
1934	198	80	49.53	2%
1944	299	70	32.80	3%
1954	628	60	15.62	6%
1964	936	50	10.48	10%
1974	2020	40	4.85	21%
1984	4146	30	2.37	42%
1994	5408	20	1.81	55%
2004	7115	10	1.38	73%
2014	9807	0	1.00	100%

In addition, according to City staff, the original cost of many of Victoria's old assets—particularly historic buildings and sewer pipes—was not recorded at all, because early cost records were not available and those assets were assumed to be fully depreciated anyway. For this reason, the City staff's recommendation is that the benchmark for determining the appropriate size of a capital contingency be replacement cost rather than original cost.

As a metric, replacement cost has its own challenges. Replacement cost estimates are typically not updated routinely; instead, they are more likely to be part of a periodic engineering assessment that might be updated every several years. In using replacement cost estimates, there are also questions about what the estimate refers to: "as is" replacement or replacement with upgrades required by current code. Property insurance records contain replacement costs for certain specific assets, such as buildings, but not for all assets, and the assumptions made in developing a replacement cost for insurance purposes might not be consistent with the assumptions made in a periodic engineering assessment of an entire group of assets. For more recently built assets (with reliable original cost data), one could also take the original cost and factor it up for inflation since the time of construction. However, that might lead to results that conflict with other estimating methods. For instance, the SOFMC multipurpose arena was placed in service in 2005. Its original cost is shown on the City books as \$35.5 million, and with ten years of inflation, one would expect the replacement cost to be about \$46.9 million. However, the property insurance replacement cost estimate for the arena is \$67.6 million. For any given single asset, those differences could probably be reconciled, but for an entire system of assets, it is not practical to spend the time to do that.

Fortunately, the capital cost contingency is just a guideline, and the total replacement cost is just a way to approximate the degree of risk represented by a given collection of existing assets. It doesn't have to be exact or completely consistent. Also, the target capital contingency level should be rounded off, lest it convey a false sense of precision. The target capital contingency is still a policy choice, albeit one that should be informed by an approximate idea about the magnitude of its potential funding responsibilities, using the best data and methods available.

e) Suggested Approach to Capital Contingency

Based on the staff's greater confidence in replacement cost data than original cost data, we suggest that the capital contingency for the City's major capital reserves be based on a percentage of the current replacement cost of the assets for which a given fund is responsible. How could the percentage be determined? Utilities are a useful starting point. Since they are capital-intensive, self-supporting enterprises, they have a long track record of capital planning and assessing infrastructure risks. For Victoria, we would suggest focusing on the water utility, since the sewer utility seems to have a large number of assets with unrecorded cost data. Then we can apply the resulting "percentage of replacement cost" guideline to other funds after adjusting for greater or lesser degrees of the risk of an emergency capital spending need.

Choosing a Percentage for the Water System – The original cost of water assets is \$60.0 million as of the end of 2013, and 1% of that amount is approximately \$600,000. We are assuming that original cost data is more reliable for the water system than for the sewer system. This comes from another assumption—that the average age of the water system is less than that of the sewer system. Sewer pipes are gravity lines, which can last for well over a hundred years before becoming so obviously impaired that they must be replaced. In contrast, with a pressurized water system, pipe failures can be strikingly obvious, so water lines are typically replaced on shorter intervals than sewer lines. So we have assumed that the water original cost data is mostly but not entirely complete, and that a suitably conservative capital contingency for the water system might be \$800,000 rather than the \$600,000 figure implied by the water original cost data. The 2013 estimated replacement cost of the water system is \$282.8 million, which means that a capital contingency of \$800,000 is approximately 0.3%

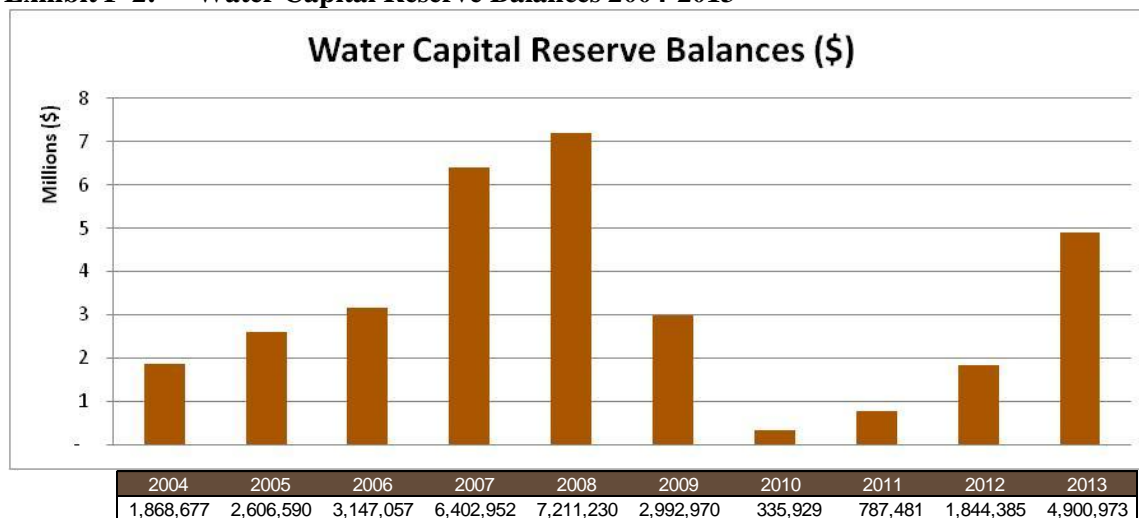
of current replacement cost. That 0.3% factor then becomes our starting point in considering the other reserve funds.

Illustration of How a Capital Contingency Functions – Before we turn our attention away from the Water capital reserve, we will use its history to illustrate how a capital contingency should work.

Exhibit F-2 shows the water capital reserve balances from 2004 through 2013. During this ten-year period, the fund balance fluctuated as one would expect a capital reserve to fluctuate, as it saved up money, then spent that money on a major capital project, and then started saving again. The low point was a 2010 fund balance of \$336,000. The implication of choosing an \$800,000 capital contingency is that during the capital planning for the water system in advance of the major pipe replacement program of 2009-2010, the forecast would not show the fund balance dropping to a level of \$336,000; instead, it would be allowed to drop only as low as \$800,000 before either the spending had to stop or the rates had to be raised even more.

Now, let us imagine that in advance of the 2009-2010 capital project, the low point of the forecast was in fact planned to be \$800,000, but that the project costs escalated beyond what had been planned, and the actual fund balance dipped down below the \$800,00 threshold, even as low as \$336,000. Such a series of events should not be assumed to represent a failure of financial planning. In this scenario, the capital contingency is simply doing its job. Beforehand, the capital contingency is telling the City when to stop spending money on a big capital project, or when rates need to be raised even higher. And then, when things turn out to cost more than expected—which sometimes happens—the capital contingency also provides a buffer, so the major capital project can either be completed or reach a logical stopping point without the water system having to incur debt.

Exhibit F-2: Water Capital Reserve Balances 2004-2013



Assessing the Risk for Other Funds – If the recommended percentage of replacement cost for the water system is 0.3%, what should it be for the other reserve funds?

The risk of surprise asset failure or cost overruns is a function of two things: the regularity and quality of capital planning, and whether the asset is visible or hidden. Pipes and the insides of buildings are invisible and therefore create a higher risk of a surprise; roadways and building exteriors are visible and therefore present less risk of a surprise.

Routine, high-quality capital planning reduces the risk of unexpected capital funding emergencies. Capital planning or facilities assessment that is more sporadic can lead to larger unpleasant surprises.

In addition to the *likelihood* of an unexpected asset failure, the *cost impact* of an asset failure can vary widely depending on the type of asset. For example, if a historical building were to develop a problem that demanded an immediate capital renovation, the cost of that renovation would probably be very high, simply because building codes have changed so much over time, and because a building is such an interconnected set of structural, plumbing, electrical, and mechanical systems that opening up one part of a building often leads to other needed renovations. On the other hand, if a section of roadway were to develop an unexpected problem, then unless the road is supported by a structure (such as a bridge or retaining walls), it is more likely that the cost of fixing the problem can be limited to the scale of the visible problem.

Suggested Percentage Targets for Capital Contingencies – Given the above discussion, we suggest that capital funds with funding responsibility for buildings have a higher capital contingency level than the utility funds. Much of the utility plant is invisible, but for that very reason, the routine system planning that is common to water, sewer, and stormwater utilities keeps this particular type of risk manageable. For Sewer and Stormwater reserves, as well as for the Parking Services Equipment & Infrastructure Fund, we suggest that the minimum capital contingency be 0.3% of asset replacement cost, the same as for the Water reserve.

Vehicles and most kinds of equipment are visible and their condition is well known. Therefore, most of their target reserve balances can be a function of their replacement cycles and capital planning. For that reason, we suggest that the City Equipment Reserve and the City Vehicles and Heavy Equipment Reserve have capital contingencies set at 0.3% of asset replacement cost. Unless a different minimum balance is required by the City's agreement with the Victoria-Esquimalt Police Board, we recommend the same capital contingency level for the Police Vehicles, Equipment & Infrastructure Fund. If the agreement requires a certain minimum balance, then of course the reserve policy should match the requirements of the agreement.

Several of the City's capital reserves have substantial funding responsibility for buildings, including the Buildings & Infrastructure Fund, the SOFMC Equipment & Infrastructure Fund, and the Victoria Conference Centre (VCC) Equipment & Infrastructure Fund, and the Recreation Facilities Equipment and Infrastructure Fund. For the Buildings & Infrastructure Fund, which has responsibility for some very old buildings, we suggest a capital contingency of 0.7% of asset replacement cost. For the SOFMC and VCC funds, which have buildings that are newer (SOFMC and VCC) or smaller (Recreation Facilities), our suggestion is that 0.5% of replacement cost would be adequate for a capital contingency.

The Recreation Facilities Equipment and Infrastructure Fund is unusual among this group of funds. It is a relatively small fund that is limited to revenue from user fees and rentals. Most capital investment in parks and recreation buildings is funded by the much larger Buildings and Infrastructure Reserve, which receives a General Fund transfer each year. However, the Recreation Facilities fund is shown here as a major capital reserve because there is a group of assets assigned to it, for which City asset data shows an original cost of \$5.8 million. For that reason, we have suggested a capital contingency for it, based on 0.5% of the replacement cost of its assigned assets.

f) Application of Suggested Capital Contingency Percentage Targets

Exhibit F-3 shows estimates for 2013 asset replacement cost and how our suggested capital contingency percentages would apply to each of the major capital reserves.² For the Buildings and Infrastructure Fund, using current estimates of replacement cost, a capital contingency at 0.7% would be about \$7.5 million. At the 0.5% threshold, the capital contingency would be \$400,000 for the Victoria Conference Centre Fund, and \$300,000 for the SOFMC Multipurpose Arena Fund.

Exhibit F-3: Major Capital Reserves and Suggested Minimum Fund Balances

Fund List	2013 Asset Original Cost	Est. 2013 Replacement Cost	Suggested Min. Reserve (% of Replacement Cost)	Implied Capital Contingency (rounded)
Police Vehicles & Equipment	\$ 11,528,760	\$ 11,528,760	0.30%	\$ 30,000
City Equipment	22,268,615	22,268,615	0.30%	70,000
City Vehicles and Heavy Equipment	29,315,846	29,315,846	0.30%	100,000
Victoria Conference Centre	22,211,759	91,034,100	0.50%	400,000
Buildings and Infrastructure	244,109,795	1,067,826,100	0.70%	7,500,000
Parking Services	6,854,666	53,467,525	0.30%	200,000
SOFMC Multipurpose Arena	35,548,380	67,613,914	0.50%	300,000
Recreation Facilities	5,821,772	25,466,572	0.50%	100,000
Water Equipment and Infrastructure	59,967,667	282,814,789	0.30%	800,000
Sewer Equipment and Infrastructure	28,877,124	332,482,665	0.30%	1,000,000
Total	\$ 466,504,384	\$ 1,983,818,886		\$10,500,000

Again, this capital contingency is unrelated to the size of the planned capital program; instead, it serves as a bottom layer of the fund balance, intended to be unspent. The total fund balance should fluctuate over time above that bottom layer, depending on the magnitude and timing of capital projects. For example, the Buildings and Infrastructure Fund had a 2013 balance of \$31.4 million, but \$7.5 million of that should be considered the fund balance “floor” (i.e., the capital contingency), so the Fund only had \$23.9 million that could be used for a planned capital program related to those assets.

² The replacement cost figures here are an amalgamation of several sources and estimating methods. In February 2012, the City staff presented replacement cost estimates to the Council that grouped the assets differently than the major capital reserves. We used those estimates for Water, Sewer, and as the starting point for our estimates of the Buildings and Infrastructure Fund. The February 2012 replacement cost estimate for “Fleet and Equipment” were less than the sum of the original cost figures for Police Vehicles and Equipment, City Equipment, and City Vehicles and Heavy Equipment, so we used the original cost numbers for those three funds. The February 2012 estimates for Roads, Bridges, Street Lighting, and Drainage System all fit within the Buildings and Infrastructure Fund, but the SOFMC Multipurpose Arena, VCC, and Recreation Facilities needed to be broken out from a “Civic Facilities” category. To deal with the SOFMC and VCC, we used an intentionally conservative method—i.e., resulting in the highest overall capital contingency. Because the SOFMC and VCC are relatively recent in construction (2005 and 1989, respectively), we could estimate their replacement cost by taking their original cost and adding inflation. For both the arena and the conference centre, their replacement costs for property insurance purposes were much higher. We subtracted the lower SOFMC and VCC estimates from the “Civic Facilities” category (leaving a higher number for the Buildings and Infrastructure Fund) but then added back the higher insurance estimates for the VCC and Multipurpose reserve funds. Finally, because our original cost data for the Recreation Facilities Fund showed that its assets represent 2.3% of the sum of that fund and the Buildings and Infrastructure Fund, we applied that same 2.3% factor to separate the replacement cost estimate for the two funds as well. All of these machinations lead to obvious uncertainty about the accuracy of the replacement cost estimates, but the City staff feels that the original cost data is even worse in terms of completeness and accuracy, so this is used as our basis for the recommended capital contingencies. Fortunately, the capital contingency is a policy choice, and all that is needed here is for that choice to be based on a rough approximation of the magnitude of capital risks, using the best available data.

F2. FUNDING THE PLANNED CAPITAL PROGRAM – MAJOR CAPITAL RESERVES

For a major capital reserve, the target balance at any given point in time will be the sum of the capital contingency and the forecasted cash flow requirements of the planned capital program.

a) Fund Balances Available for Planned Capital Expenditures

Exhibit F-4 below shows the major capital reserves along with the amount of their 2013 fund balances above the capital contingency, in relation to the estimated 2013 replacement cost of the assets. For each reserve, the “fund balance minus capital contingency” represents the portion of the balance that is available to smooth out the peaks and valleys of planned capital expenditures.

Exhibit F-4: Reserve Balance in Relation to Current Replacement Cost of Assets

Fund List	2013 Asset Original Cost	Est. 2013 Replacement Cost	Fund Balance FYE 2013	Suggested Capital Contingency	Fund Balance Minus Capital Contingency	Fund Balance minus Capital Contingency as % of Replacement Cost
Police Vehicles & Equipment	\$ 11,528,760	\$ 11,528,760	\$ 1,657,651	\$ 30,000	\$ 1,627,651	14%
City Equipment	22,268,615	22,268,615	5,542,460	70,000	5,472,460	25%
City Vehicles and Heavy Equipment	29,315,846	29,315,846	5,396,227	100,000	5,296,227	18%
Victoria Conference Centre	22,211,759	91,034,100	602,900	400,000	202,900	0%
Buildings and Infrastructure	244,109,795	1,067,826,100	31,351,148	7,500,000	23,851,148	2%
Parking Services	6,854,666	53,467,525	5,612,904	200,000	5,412,904	10%
SOFMC Multipurpose Arena	35,548,380	67,613,914	563,589	300,000	263,589	0%
Recreation Facilities	5,821,772	25,466,572	1,513,080	100,000	1,413,080	6%
Water Equipment and Infrastructure	59,967,667	282,814,789	4,900,973	800,000	4,100,973	1%
Sewer Equipment and Infrastructure	28,877,124	332,482,665	16,403,688	1,000,000	15,403,688	5%
Total	\$ 466,504,384	\$ 1,983,818,886	\$ 73,544,620	\$ 10,500,000	\$ 63,044,620	3%

This shows that taken as a whole, the three reserves that are responsible for vehicles and equipment are funded at between 14% and 25% of estimated replacement cost. Given the relatively short useful life of vehicles and equipment, this percentage would be expected to be high. For building and road-related infrastructure, the amount currently available to fund planned capital expenditures is only about 2% of the estimated current replacement cost. The analogous percentages are 5% for the sewer system and only 1% for the water system at the end of 2013. For the VCC and Multipurpose Arena funds, almost all of their reserves consist of capital contingency, so very little is available for planned capital spending.

How should a program of capital expenditures be converted into a cash flow forecast that includes projected reserve balances in future years? We will show this by focusing on an extended example from the Buildings and Infrastructure Fund. While the tables and projected reserve balances are specific to that fund, the approach can be generalized to the other major capital funds as well.

b) Example Capital Program for Buildings and Infrastructure Fund

The Buildings and Infrastructure Fund does not have a current master plan that addresses the replacement and renovation of all of its assets, but a 2008 assessment of City facilities is available that at least addresses the majority (though not all) of the assets for which the Buildings and Infrastructure Fund is responsible. We took the 2008 estimates, added estimated inflation to bring it to 2014 constant dollars, and developed an example facilities capital program for a 20-year period.

This example facilities capital program is shown in Exhibit F-5 on the following pages. It reveals annual spending needs that range from \$5 million to \$32 million in any given year. We made some assumptions about “expenditure smoothing,” shifting costs from one year to another to arrive at a less variable spending pattern ranging from \$8 million to \$14 million, still in 2014 constant dollars. To this smoothed pattern of expenditures we added projected inflation over the 20-year forecast period to arrive at a nominal-dollar estimate of the cash flow needs of the capital program.

Exhibit F-5: Example Facilities Capital Program

Example Facilities Capital Program

Based on City Facilities Assessment (2008)

Name of Facility	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
Aviary/Info Kiosk	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 5,548	\$ 2,162	\$ 3,145	\$ -	\$ -	\$ -
Bastion Square Parkade	112,807	10,894	-	7,326	-	-	35,204	926,958	58,737	21,721	51,569
Beacon Hill Main Administration Offices	314,403	29,747	-	366,379	40,305	56,850	49,624	-	486,551	216,434	65,231
BHP Main Public Washrooms	-	14,203	33,895	34,888	-	1,651	18,720	31,608	144,844	-	11,867
BHP Service Building, Mansard Roof	-	164,066	41,479	23,235	91,255	106,241	101,245	-	31,171	-	-
Burnside Gorge Community Centre	-	-	-	-	427,547	-	70,774	-	-	218,792	-
Cameron Bandstand	77,446	21,328	-	69,713	-	5,055	61,852	-	44,234	5,884	2,919
Centennial Arcade	376,407	294,250	36,967	530,806	-	-	70,924	120,179	38,063	102,879	82,845
Centennial Square Parkade	162,166	410,713	-	-	117,023	-	222,477	262,427	-	12,999	16,466
Chequers Building aka Lookout	221,538	-	-	33,352	-	-	-	-	16,351	-	-
Children's Petting Zoo	33,381	17,130	-	6,025	2,616	-	338	-	17,294	-	5,627
Children's Zoo Gazebos & Shelters (East)	9,480	-	-	-	-	-	-	-	15,388	-	-
Children's Zoo Gazebos & Shelters (West)	9,603	3,722	-	-	-	-	-	-	15,388	-	-
City Hall - New Building	2,091,964	429,703	517,698	1,393,858	349,653	240,663	377,176	208,643	218,449	490,466	239,466
City Hall - Old Building	2,051,677	-	455,105	1,349,410	288,909	151,517	64,351	1,275,443	-	558,850	43,872
Cook @ Dallas Comfort Station	-	22,971	-	445	13,661	-	6,740	-	1,527	-	-
Cook Street Village Activity Centre	-	33,396	135,559	281,308	89,336	137,959	140,532	-	821,431	-	35,891
Cricket Pavilion	138,855	23,183	-	2,953	-	1,795	13,993	-	52,311	24,779	-
Crystal Garden Conference Centre	-	-	-	-	-	409,326	-	122,432	-	-	77,497
Crystal Pool	5,355,029	559,374	85,998	922,088	4,239,067	52,426	672,991	-	-	3,675,013	-
Fairfield Gonzales Community Centre	295,450	8,064	3,252	269,683	-	73,576	125,446	4,876	489,160	41,028	176,063
Fernwood Community Centre	70,113	31,536	37,281	147,541	34,727	472,231	69,221	145,159	89,666	68,374	-
Finlayson Point Shelter	-	5,235	-	-	-	-	2,530	-	-	-	-
Fire Hall # 1	1,385,862	507,848	44,360	1,465,485	133,997	-	545,879	456,493	-	153,984	182,811
Fire Hall # 2	76,768	71,147	-	351,823	-	-	19,032	203,326	153,842	59,004	-
Fire Hall # 3	175,556	62,691	13,969	49,190	25,108	-	69,358	51,425	152,979	-	18,556
Garbage Transfer Station	17,988	16,131	-	-	-	-	3,100	-	-	345	-
Garry Oak Room	-	86,270	44,655	21,932	-	-	68,681	-	61,366	-	-
Gas Pump Shelter	47,128	12,059	-	-	-	-	169	6,614	-	3,296	-
Gonzales Park Comfort Station	-	23,292	12,589	37,538	6,752	-	6,336	-	7,114	-	-
Holland Point Comfort Station	-	22,971	-	445	3,969	3,435	6,740	-	1,527	-	-
Hollywood Park Comfort Station	-	6,416	22,392	24,019	19,102	14,790	10,220	-	-	-	-
Irving Park Comfort Station	-	5,426	26,509	13,443	5,777	4,156	4,334	-	8,936	-	-
Island Saw	-	1,152	30,858	184,680	21,913	129,603	231,150	39,734	-	-	354,499
James Bay New Horizons	193,890	-	18,355	106,714	-	110,834	120,435	194,396	158,426	315,684	12,680
Johnson Street Bridge Controls House	45,619	2,562	-	6,937	-	-	507	-	-	14,944	46,635
Johnson Street Parkade	17,010	-	52,541	9,330	-	-	16,931	-	-	-	85,697
Main Admin. Building And Shops	1,975,549	385,740	536,492	163,047	102,924	425,547	210,229	-	508,900	347,069	246,828
Maintenance Garage and Workshops	73,423	-	35,682	36,676	11,798	-	28,414	-	9,025	-	-
Masonry Block Building (Beside Stores)	5,407	1,785	-	-	-	-	-	-	-	-	-
Memorial Crescent Comfort Station	-	7,066	20,113	25,127	734	-	-	-	-	-	-
Nursery attached to GH 1 and 2	216,560	-	-	135,460	47,425	82,116	-	69,714	-	57,764	-
Nursery Way Comfort Station	-	10,205	38,655	11,569	6,241	4,257	28,510	-	-	-	-

Exhibit F-5: Example Facilities Capital Program, continued

Example Facilities Capital Program

Based on City Facilities Assessment (2008)

Name of Facility	Year 12	Year 13	Year 14	Year 15	Year 16	Year 17	Year 18	Year 19	Year 20	20-Year Total
Aviary/Info Kiosk	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 32,887	\$ 10,004	\$ -	\$ -	\$ 53,745
Bastion Square Parkade	17,244	-	371,448	-	60,899	-	-	1,093,874	-	2,768,680
Beacon Hill Main Administration Offices	120,069	-	-	13,941	-	78,552	-	293,713	96,897	2,228,695
BHP Main Public Washrooms	19,030	-	-	-	-	-	-	-	-	310,707
BHP Service Building, Mansard Roof	28,148	-	29,109	29,734	17,357	139,139	-	-	-	802,179
Burnside Gorge Community Centre	-	263,325	-	1,917,545	-	-	-	122,809	1,103,135	4,123,927
Cameron Bandstand	18,319	-	9,725	-	-	60,531	-	-	2,970	379,974
Centennial Arcade	-	-	29,882	-	33,107	149,252	-	284,787	559,083	2,709,431
Centennial Square Parkade	20,799	-	-	-	-	352,169	-	-	250,887	1,828,126
Chequers Building aka Lookout	-	-	94,296	-	-	-	-	46,452	-	411,988
Children's Petting Zoo	-	-	-	-	-	20,889	-	-	-	103,303
Children's Zoo Gazebos & Shelters (East)	-	3,959	-	-	-	17,408	-	-	-	46,234
Children's Zoo Gazebos & Shelters (West)	5,892	3,959	-	-	-	17,408	-	-	-	55,971
City Hall - New Building	562,936	435,879	642,812	936,152	301,284	1,021,213	1,088,892	606,196	776,383	12,929,484
City Hall - Old Building	161,890	-	98,334	344,278	198,720	631,024	974,992	1,210,430	884,631	10,743,432
Cook @ Dallas Comfort Station	-	-	-	-	-	5,296	-	-	-	50,639
Cook Street Village Activity Centre	86,943	32,445	257,934	141,415	-	147,664	-	213,873	-	2,555,689
Cricket Pavilion	34,883	-	-	-	2,842	61,124	-	-	59,286	416,005
Crystal Garden Conference Centre	-	-	-	-	2,009,297	-	-	-	212,450	2,831,002
Crystal Pool	854,910	48,697	1,267,457	87,271	-	2,168,608	204,865	304,713	508,921	21,007,429
Fairfield Gonzales Community Centre	83,708	141,788	88,686	-	106,501	78,357	7,719	-	104,843	2,098,200
Fernwood Community Centre	12,304	-	25,401	-	580,322	317,903	-	38,963	294,428	2,435,170
Finlayson Point Shelter	-	-	-	-	-	4,005	-	-	-	11,771
Fire Hall # 1	5,749	-	187,463	406,298	-	278,053	-	397,285	985,759	7,137,326
Fire Hall # 2	-	-	790,323	-	-	202,198	-	521,512	446,220	2,895,196
Fire Hall # 3	36,177	-	292,125	-	-	14,745	-	91,795	-	1,053,674
Garbage Transfer Station	-	-	-	-	-	5,076	-	-	23,240	65,880
Garry Oak Room	125,266	-	-	-	-	101,115	-	43,679	-	552,965
Gas Pump Shelter	-	448,746	-	-	-	-	-	7,554	104,597	630,163
Gonzales Park Comfort Station	2,606	-	-	-	-	24,371	-	-	-	120,597
Holland Point Comfort Station	-	-	-	-	-	5,296	-	-	-	44,382
Hollywood Park Comfort Station	-	-	-	7,088	-	30,030	-	-	-	134,056
Irving Park Comfort Station	-	-	-	-	-	50,287	-	-	-	118,867
Island Saw	-	46,624	190,290	28,743	31,595	-	-	50,020	-	1,340,861
James Bay New Horizons	-	-	278,413	-	302,783	103,179	85,829	42,042	172,474	2,216,132
Johnson Street Bridge Controls House	9,961	-	-	-	-	20,847	-	44,772	23,655	216,439
Johnson Street Parkade	-	-	3,445,704	352,237	44,889	-	-	38,882	-	4,063,222
Main Admin. Building And Shops	237,986	1,392,554	153,252	-	375,392	370,432	744,756	210,907	623,769	9,011,374
Maintenance Garage and Workshops	-	-	-	-	19,194	19,684	-	-	-	233,896
Masonry Block Building (Beside Stores)	-	-	-	-	-	6,963	-	-	-	14,156
Memorial Crescent Comfort Station	-	-	-	-	-	10,855	12,473	-	-	76,369
Nursery attached to GH 1 and 2	185,387	-	1,238	38,233	-	13,514	-	144,443	-	991,852
Nursery Way Comfort Station	-	-	-	-	6,738	125,289	-	-	-	231,465

Exhibit F-5: Example Facilities Capital Program, continued

Example Facilities Capital Program

Based on City Facilities Assessment (2008)

Name of Facility	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
Oaklands Community Centre	73,463	-	9,566	28,098	-	98,758	28,907	-	67,396	46,890	261,733
Oaklands Park Comfort Station	-	28,797	36,260	33,727	23,745	-	26,969	-	11,915	-	-
Pandora Administration Offices	304,358	165,560	280,251	556,135	-	149,324	78,656	175,354	60,629	62,660	284,585
Paving Plant	20,829	7,583	-	11,909	-	-	4,430	-	-	3,621	-
Pemberton Park Comfort Station	13,823	21,851	9,301	59,468	-	-	29,429	-	-	-	-
Police Stables	15,168	-	-	17,444	-	5,114	8,506	-	31,618	-	-
Quadra Village Community Centre	385,476	9,245	32,240	95,745	97,902	243,264	100,414	386,084	164,584	-	-
RAP Admin, and Baseball	302,808	119,965	253,149	93,171	19,048	-	30,173	21,851	22,964	13,585	-
RAP Entrance Pavilion Box Office	326,860	119,965	247,023	23,428	767	-	30,173	21,851	527	547	10,827
RAP Soccer Grandstand	554,547	299,912	528,443	1,045,050	-	-	-	83,282	10,760	25,971	27,083
RAP Storage Building	30,378	11,140	-	-	-	-	169	-	-	-	-
RAP Storage Sheds	-	3,672	-	-	-	-	-	-	-	-	-
Repair Shop Attached to Admin Offices	56,836	-	-	19,368	11,985	-	1,008	-	34,561	-	-
Save-On-Foods Memorial Centre	383,622	2,610,116	-	317,022	-	-	2,233,429	-	-	779,112	-
Small Parks Building	33,050	-	-	12,063	10,760	-	12,674	-	28,952	67,319	1,078
Sports Hut	109,756	1,302	-	30,632	-	-	3,800	9,940	2,170	-	-
Stadacona Park Comfort Station	-	-	-	14,816	-	-	16,330	-	11,002	-	-
Storage Buildings & Sheds	105,407	75,726	-	-	-	-	79,009	-	-	14,006	14,380
Stores w/Annex	94,153	19,434	63,632	357,001	49,921	-	-	-	429,415	-	-
Tire Shed @100 Cook St.	1,226	-	-	-	9,409	-	12,435	-	-	-	-
Topaz Park Field House	-	49,327	42,806	65,042	99,860	20,635	134,665	-	28,536	-	-
Topaz Park Service Building	-	6,699	1,151	53,451	1,935	4,294	10,256	-	22,287	-	-
Vic West Park Comfort Station	-	4,713	38,184	22,818	32,757	-	15,824	-	-	-	-
Victoria Conference Centre	8,663,402	434,624	297,729	327,721	336,534	8,549,364	1,320,254	-	-	2,913,726	3,054,988
Victoria Police Headquarters	4,962,807	29,315	916,818	1,199,911	564,264	1,140,530	6,013,931	-	-	1,932,772	-
Victoria West Community Centre	288,154	-	98,309	297,577	155,024	46,852	37,856	47,952	36,423	-	35,085
View Street Parkade	335,741	-	-	50,734	67,808	-	4,397	1,039,941	-	16,314	509,906
McDonald Park Field House & Washrooms	17,560	26,212	799	55,434	-	24,233	135,799	-	7,906	-	-
Ross Bay Cemetery Svc Bldg Washroom	66,515	-	-	14,139	12,873	-	-	2,847	-	2,601	-
Total (2014 Constant Dollars)	\$32,697,021	\$ 7,347,437	\$ 5,100,070	\$12,884,336	\$ 7,574,435	\$12,771,948	\$13,845,829	\$ 5,911,678	\$ 4,574,334	\$12,268,441	\$ 5,956,695
<i>Note: Facilities yet to be included in these estimates include Library as well as Curling Club and other leased buildings.</i>											
Average per Year (Constant Dollars)	11,578,615										
<i>Assumed Expenditure Smoothing:</i>											
Spread 2014 projects over next 5 years	(20,000,000)	5,000,000	8,000,000	1,000,000	6,000,000						
Spread 2025 projects over previous 4 years								4,000,000	4,000,000		4,000,000
Spread 2030 projects over previous 4 years											
Spread 2033 projects over previous 2 years											
Smoothed Total (Constant Dollars)	\$12,697,021	\$12,347,437	\$13,100,070	\$13,884,336	\$13,574,435	\$12,771,948	\$13,845,829	\$ 9,911,678	\$ 8,574,334	\$12,268,441	\$ 9,956,695
Assumed Annual Inflation	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%
Total Facilities Capital (Inflated Dollars)	\$12,697,021	\$12,717,860	\$13,897,865	\$15,171,789	\$15,278,146	\$14,806,188	\$16,532,644	\$12,190,114	\$10,861,710	\$16,007,533	\$13,380,966

Exhibit F-5: Example Facilities Capital Program, continued

Example Facilities Capital Program

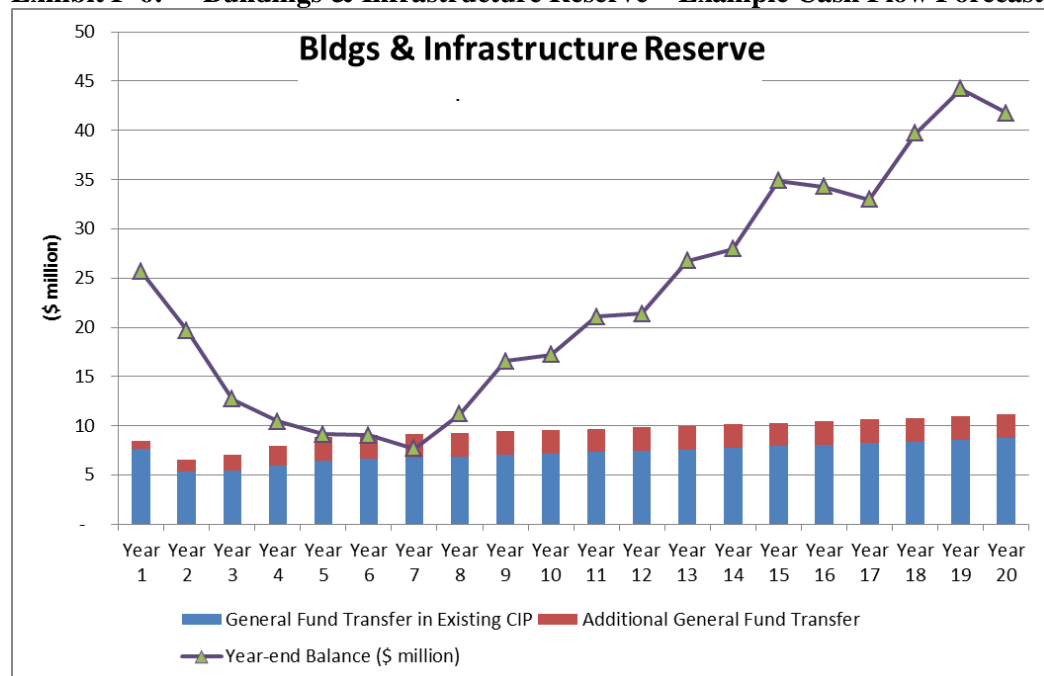
Based on City Facilities Assessment (2008)

Name of Facility	Year 12	Year 13	Year 14	Year 15	Year 16	Year 17	Year 18	Year 19	Year 20	20-Year Total
Oaklands Community Centre	-	31,760	-	-	208,527	21,530	-	46,497	74,225	997,350
Oaklands Park Comfort Station	-	-	-	-	-	45,404	-	-	-	206,819
Pandora Administration Offices	246,727	-	125,928	-	700,198	74,460	68,142	322,371	99,188	3,754,526
Paving Plant	-	-	-	-	-	6,478	-	-	6,173	61,023
Pemberton Park Comfort Station	-	-	-	-	6,717	46,120	-	-	-	186,709
Police Stables	12,808	-	-	-	-	45,260	-	-	-	135,918
Quadra Village Community Centre	14,634	1,204,774	19,304	15,447	700,658	302,745	961,806	70,490	-	4,804,812
RAP Admin, and Baseball	86,434	-	1,238	29,549	-	59,773	9,315	42,226	75,561	1,180,810
RAP Entrance Pavilion Box Office	24,415	-	1,238	17,757	-	59,773	375	6,710	54,923	947,159
RAP Soccer Grandstand	238,357	-	11,344	79,845	-	124,037	112,957	113,656	81,464	3,336,708
RAP Storage Building	42,376	-	-	-	-	-	-	-	-	84,063
RAP Storage Sheds	6,014	-	-	-	-	-	-	-	-	9,686
Repair Shop Attached to Admin Offices	-	-	6,260	-	52,996	-	-	-	-	183,014
Save-On-Foods Memorial Centre	10,914,569	-	-	-	495,313	12,489,644	-	-	-	30,222,826
Small Parks Building	-	-	-	-	-	20,063	63,261	-	-	249,221
Sports Hut	5,347	-	-	21,683	-	3,076	-	7,252	-	194,959
Stadacona Park Comfort Station	-	-	-	-	5,120	30,742	-	-	-	78,011
Storage Buildings & Sheds	8,225	-	-	-	-	4,285	-	-	22,170	323,207
Stores w/Annex	-	-	6,103	-	-	38,706	-	-	-	1,058,365
Tire Shed @100 Cook St.	-	-	-	-	-	19,684	-	-	-	42,755
Topaz Park Field House	-	-	35,511	-	-	258,949	42,630	36,259	-	814,221
Topaz Park Service Building	-	-	132,623	3,063	6,797	34,799	-	7,521	-	284,874
Vic West Park Comfort Station	-	-	-	-	-	31,054	-	-	-	145,351
Victoria Conference Centre	2,007,201	-	-	-	2,676,156	858,963	-	-	6,494,971	37,935,631
Victoria Police Headquarters	8,192,247	1,925,580	-	565,569	454,516	3,893,372	1,480,852	880,850	3,059,478	37,212,813
Victoria West Community Centre	136,844	71,019	281,681	33,669	74,980	30,443	223,350	28,602	20,097	1,943,917
View Street Parkade	-	-	-	-	393,582	9,175	-	86,452	135,977	2,650,027
McDonald Park Field House & Washrooms	-	-	2,883	-	26,859	3,695	-	-	-	301,379
Ross Bay Cemetery Svc Bldg Washroom	3,561	-	2,502	1,569	-	-	44,939	-	23,743	175,289
Total (2014 Constant Dollars)	\$24,569,980	\$ 6,051,121	\$ 8,880,518	\$ 5,071,102	\$ 9,893,355	\$25,197,608	\$ 6,137,175	\$ 7,457,605	\$17,381,616	\$231,572,305
<i>Note: Facilities yet to be included in these estimates include Library as well as Curling Club and other leased buildings.</i>										
Average per Year (Constant Dollars)										
Assumed Expenditure Smoothing:										
Spread 2014 projects over next 5 years										
Spread 2025 projects over previous 4 years	(12,000,000)									
Spread 2030 projects over previous 4 years		3,000,000	3,000,000	3,000,000	3,000,000	(12,000,000)				
Spread 2033 projects over previous 2 years							2,000,000	2,000,000	(4,000,000)	
Smoothed Total (Constant Dollars)	\$12,569,980	\$ 9,051,121	\$11,880,518	\$ 8,071,102	\$12,893,355	\$13,197,608	\$ 8,137,175	\$ 9,457,605	\$13,381,616	\$231,572,305
Assumed Annual Inflation	3%	3%	3%	3%	3%	3%	3%	3%	3%	
Total Facilities Capital (Inflated Dollars)	\$17,399,792	\$12,904,735	\$17,446,941	\$12,208,266	\$20,087,427	\$21,178,286	\$13,449,510	\$16,100,940	\$23,464,744	\$307,782,476

The bottom line from the example capital program in Exhibit F-5 is the total facilities cost using inflated dollars. Using these forecasted costs, we then prepared a 20-year cash flow projection for the Buildings and Infrastructure Fund, showing the amount of resources that would be required in order to pay for those capital costs.

The results of this cash flow forecast are depicted graphically in Exhibit F-6, and the detailed calculations are shown on Exhibit F-7 on the following page. In keeping with our recommended capital contingency for that fund, this forecast assumes a minimum balance of approximately \$7.5 million.

Exhibit F-6: Buildings & Infrastructure Reserve – Example Cash Flow Forecast



In this cash flow forecast, the key question is not the reserve balance but the General Fund transfer required in any given year.

The forecast starts with the General Fund transfers already assumed in the City's revenue forecast and Capital Improvement Program (the blue bars) and then identifies how much additional transfer will be required in order to fully fund the example capital program (the red bars). As it turns out, the additional operating transfer grows gradually to \$2.4 million in Year 5, after which the level is sustained through the rest of the time horizon.

The triangles in Exhibit F-6 show the projected fund balance at the end of each year. In this forecast, the fund balance is drawn down until year 7, when it hits the minimum capital contingency. After that, the fund balance begins to increase through the rest of the forecast period. Its high point is about \$44 million in Year 19. However, well before the City reaches Year 19, the City's periodic capital planning will have provided updated asset condition assessments and cost estimates, so that the projected General Fund transfers and reserve fund balances can be updated.

Exhibit F-7: Cash Flow Forecast for Buildings and Infrastructure Reserve

Buildings & Infrastructure Reserve Example Cash Flow Forecast											
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
<i>Drawn from 2014-2033 CIP plus example facilities capital program</i>											
Beginning Balance	\$31,351,148	\$25,432,524	\$19,497,720	\$12,483,658	\$10,214,676	\$ 8,935,034	\$ 8,823,172	\$ 7,447,537	\$11,004,855	\$16,324,334	\$17,015,913
Revenue:											
Capital Levy	10,192,327	11,925,781	12,480,931	13,483,225	14,470,318	16,754,501	17,856,320	17,938,355	18,824,266	19,684,720	20,453,752
Capital Levy Increase	1,218,354	1,117,858	1,345,710	1,226,075	1,213,940	1,196,986	1,179,108	980,145	1,380,179	708,781	735,145
Transfers In from General Fund per CIP	7,674,600	5,377,893	5,481,251	5,984,677	6,488,171	6,617,934	6,750,293	6,885,299	7,023,005	7,163,465	7,306,734
Additional Gen Fund Transfers	800,000	1,200,000	1,600,000	2,000,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000
Interest Income @ 1.25%	352,694	279,070	198,642	140,983	118,942	110,299	101,060	114,611	169,747	207,082	235,179
Total Revenue	\$20,237,975	\$19,900,602	\$21,106,534	\$22,834,960	\$24,691,371	\$27,079,720	\$28,286,782	\$28,318,410	\$29,797,196	\$30,164,049	\$31,130,810
Information: Total General Fund Transfer	8,474,600	6,577,893	7,081,251	7,984,677	8,888,171	9,017,934	9,150,293	9,285,299	9,423,005	9,563,465	9,706,734
Capital Expenditures:											
<i>Excludes Projects Funded by Grants, Other Funds, Debt, or Cost Sharing</i>											
Facility Projects (from example program)	\$12,697,021	\$12,717,860	\$13,897,865	\$15,171,789	\$15,278,146	\$14,806,188	\$16,532,644	\$12,190,114	\$10,861,710	\$16,007,533	\$13,380,966
Street/Storm/Park/Other Projects (from CIP)	13,459,578	13,117,546	14,222,731	9,932,154	10,692,866	12,385,394	13,129,772	12,570,978	13,616,008	13,464,937	13,917,844
Total Capital Expenditures	\$26,156,599	\$25,835,406	\$28,120,596	\$25,103,942	\$25,971,013	\$27,191,582	\$29,662,417	\$24,761,092	\$24,477,718	\$29,472,470	\$27,298,810
Net Increase/(Decrease) in Reserve Balance	\$ (5,918,624)	\$ (5,934,804)	\$ (7,014,062)	\$ (2,268,982)	\$ (1,279,642)	\$ (111,862)	\$ (1,375,635)	\$ 3,557,318	\$ 5,319,478	\$ 691,579	\$ 3,832,000
Ending Balance	\$25,432,524	\$19,497,720	\$12,483,658	\$10,214,676	\$ 8,935,034	\$ 8,823,172	\$ 7,447,537	\$11,004,855	\$16,324,334	\$17,015,913	\$20,847,912

Buildings & Infrastructure Reserve Example Cash Flow Forecast											20-Year Total
	Year 12	Year 13	Year 14	Year 15	Year 16	Year 17	Year 18	Year 19	Year 20		
<i>Drawn from 2014-2033 CIP plus example facilities capital program</i>											
Beginning Balance	\$20,847,912	\$21,176,004	\$26,503,317	\$27,746,929	\$34,661,806	\$34,069,505	\$32,713,610	\$39,466,165	\$43,990,409		\$ 31,351,148
Revenue:											
Capital Levy	21,228,391	21,939,870	22,555,554	23,185,671	23,667,397	24,158,756	24,659,943	25,176,700	25,185,962		385,822,739
Capital Levy Increase	760,417	598,145	552,201	459,096	468,277	477,644	487,194	497,014	589,316		17,191,587
Transfers In from General Fund per CIP	7,452,869	7,601,926	7,753,965	7,909,044	8,067,225	8,228,569	8,393,141	8,561,004	8,732,224		145,453,287
Additional Gen Fund Transfers	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000		44,000,000
Interest Income @ 1.25%	261,018	296,145	336,958	387,632	426,903	414,802	448,322	518,364	531,144		5,649,597
Total Revenue	\$32,102,695	\$32,836,086	\$33,598,678	\$34,341,443	\$35,029,801	\$35,679,771	\$36,388,600	\$37,153,081	\$37,438,645		\$598,117,209
Information: Total General Fund Transfer	9,852,869	10,001,926	10,153,965	10,309,044	10,467,225	10,628,569	10,793,141	10,961,004	11,132,224		189,453,287
Capital Expenditures:											
<i>Excludes Projects Funded by Grants, Other Funds, Debt, or Cost Sharing</i>											
Facility Projects (from example program)	\$17,399,792	\$12,904,735	\$17,446,941	\$12,208,266	\$20,087,427	\$21,178,286	\$13,449,510	\$16,100,940	\$23,464,744		\$307,782,476
Street/Storm/Park/Other Projects (from CIP)	14,374,812	14,604,037	14,908,126	15,218,300	15,534,676	15,857,380	16,186,535	16,527,898	16,440,541		280,162,112
Total Capital Expenditures	\$31,774,604	\$27,508,772	\$32,355,067	\$27,426,566	\$35,622,102	\$37,035,666	\$29,636,045	\$32,628,837	\$39,905,286		\$587,944,588
Net Increase/(Decrease) in Reserve Balance	\$ 328,091	\$ 5,327,314	\$ 1,243,611	\$ 6,914,877	\$ (592,301)	\$ (1,355,895)	\$ 6,752,555	\$ 4,524,244	\$ (2,466,640)		\$ 10,172,621
Ending Balance	\$21,176,004	\$26,503,317	\$27,746,929	\$34,661,806	\$34,069,505	\$32,713,610	\$39,466,165	\$43,990,409	\$41,523,769		\$ 41,523,769

Applying this Approach to Other Funds – The approach demonstrated above—determining the multi-year capital program, then forecasting the cash required to carry it out—should be used not just for the Buildings and Infrastructure reserve but also the other major capital reserves.

For Parking Services and Victoria Conference Centre reserves, the intent has been for the respective programs to generate their own revenues to be transferred into the related capital reserve, rather than relying on property tax revenue. Parking Services is financially healthy, and this assumption of self-sufficiency is warranted. However, with the VCC Reserve, recent years have shown that VCC program revenue cannot by itself fund all of the capital needs of the facility. In both of these cases, the cash flow forecast will show a revenue stream generated by their respective facilities, but in the case of VCC, the forecast will probably also need to contain a revenue line for transfers from the General Fund from property taxes, addressing the gap between the capital needs and the available program revenue.

It is important to observe that unlike other kinds of reserves, with the major capital reserves the target balance cannot be based only on a simple formula, such as a percentage of some quantity such as operating expenses or capital asset value. A formula can only be used for the minimum balance—the capital contingency. But most of the fund balance will consist of dollars set aside for future planned capital costs, and the requirements will fluctuate over the years. For the major capital reserves, there is no substitute for frequent capital planning. We recommend that for each of the major capital reserves other than the vehicle/equipment reserves, a comprehensive system plan be updated not less often than every six years. For the vehicle/equipment reserves, a replacement schedule should be maintained on an ongoing basis. System planning is a type of capital cost, necessary to inform the decision-making with respect to other capital costs.

F3. PROPERTY ACQUISITION RESERVES

The City has two property acquisition reserves, the Parks and Greenways Acquisition Fund and the Tax Sale Lands Fund. These two funds are not responsible for a group of existing assets, so there is no need for a capital contingency, but they should have a target balance that is a function of a planned acquisition strategy.

In any real estate transaction, the economic advantage depends heavily on the timing of cash needs and who is most motivated to buy or sell. For a given parcel of land, if the City is more motivated to buy than the owner is to sell, then that parcel will come with a high price. For instance, if the property is on the verge of being developed and the City desperately wants to secure the land in public ownership, then the price will be steep. However, if the seller is motivated—for example, if the seller needs to convert property into cash—then a good deal is more likely to be available. The purpose of a property acquisition reserve is to have cash available to take advantage of the good deals at the time they are available. In combination with a proactive, planned land acquisition program, the City can fill in gaps in the park system or other property needs, and do so economically.

a) Park Land Acquisition

A planned park acquisition program should include a list of either target properties or criteria for target acquisitions. If there is a list of specific parcels that would be desirable for purchase, then if funding is available, City staff can proactively engage with the property owners. Alternatively (or at the same time), the City's acquisition program can state certain criteria for desirable purchases (ranked into high, medium, and low priorities). For example, the plan could identify certain neighborhoods that are considered park-deficient and then assign a high priority to the acquisition of parcels of at least .5 hectare for development into a neighborhood park in those neighborhoods. The second approach is more opportunity-driven and less proactive, but both can be effective. What would *not* be advisable would be to have a large reserve balance without also having clear criteria

and priorities. A disciplined approach to land acquisition will yield the most favorable result to City taxpayers.

How large should a park land acquisition reserve be? It can logically be tied to the likely cost of acquiring certain types of land. We suggest that the reserve target be tied to the estimated cost of acquiring 1.5 hectares of land in specified park-deficient neighborhoods. (We are assuming that a standard neighborhood park would be at least .5 hectare in size. If Victoria park development standards vary from that assumption, the reserve guideline should be adjusted accordingly.) Because land values will probably rise faster than general inflation, a park land acquisition reserve will probably require a constant, low-level stream of revenue to keep up with the target fund balance, even before any acquisitions draw down on the reserve. Then, when an acquisition is made, the policy should specify a period of time for replenishment of the reserve, such as 3-5 years.

If this fund's revenue stream is limited to 10% of the proceeds of City land sales, a replenishment policy cannot be followed strictly, because the timing of City land sales is uncertain. In order to ensure that reserves drawn down for acquisitions are subsequently replenished within a certain number of years, proceeds from City land sales might need to be supplemented by a reliable source of funding.

b) Tax Sale Lands Reserve

The Tax Sale Lands Reserve should follow the same concept as the Parks and Greenways Acquisition Reserve. The purpose of the property acquisitions might differ and therefore the basis for the minimum balance might likewise differ. Also, the Tax Sale Lands Reserve is not only for acquisition but also remediation of its acquired properties. But for both of these funds, there should be an acquisition strategy that contains a prioritized list of target properties or a set of prioritized criteria for acquisitions. The recommended target balance should be a function of how much money would be needed in order to acquire some number of hectares or parcels under the acquisition strategy, so that the City can move quickly when an opportunity arises that fits the criteria. After making an acquisition, the fund should be replenished as soon as possible, so the cash can be available to make further acquisitions that fit the strategy.

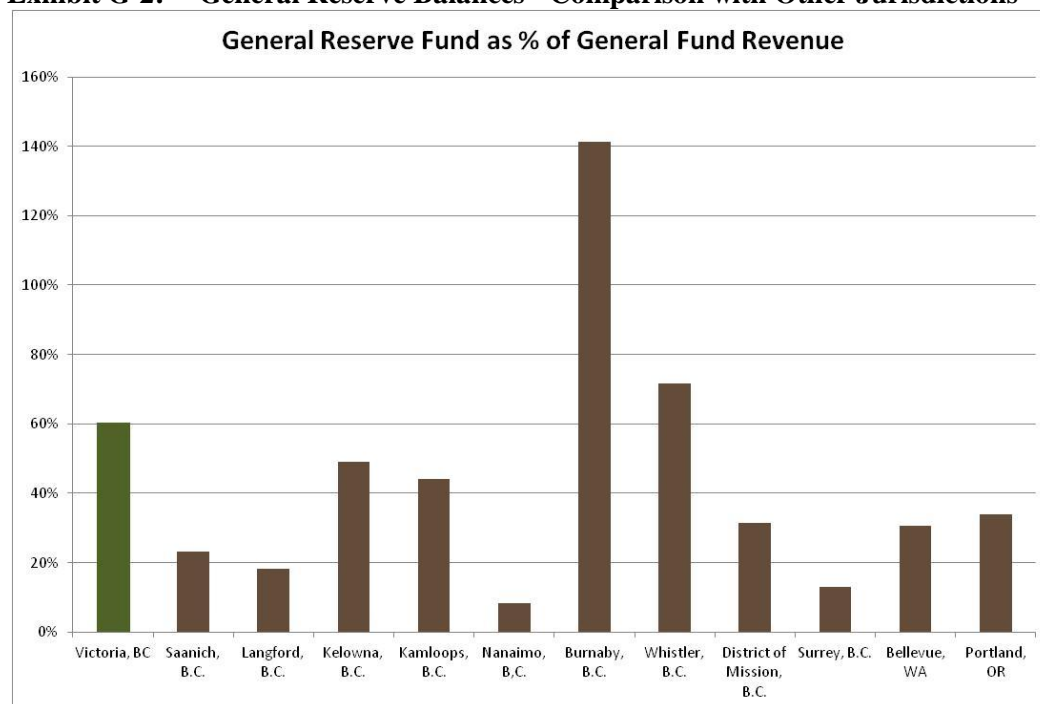
G. COMPARISON WITH OTHER JURISDICTIONS

Exhibits G-1 and G-2 show a comparison between Victoria and other municipalities in the level of general operating and capital reserves as a percentage of general revenue.

Exhibit G-1: 2013 General Operating and Capital Reserves as Percentage of General Revenue

Jurisdiction	Population (as of last census)	Total Non-Proprietary Fund Revenue	Total Non-Proprietary Reserve Fund Balance	General Reserve Fund as % of General Fund Revenue	Sources
Victoria, BC	80,032	\$ 182,294,871	\$ 109,803,000	60%	2013 Annual Report P. 13, 69
Saanich, B.C.	109,752	\$ 130,935,781	\$ 30,336,101	23%	2013 Annual Report P. 74
Langford, B.C.	29,228	\$ 51,742,613	\$ 9,417,169	18%	2013 Annual Report P. 83
Kelowna, B.C.	120,000	\$ 195,836,000	\$ 96,247,000	49%	2013 Annual Report p. 43
Kamloops, B.C.	85,678	\$ 148,845,890	\$ 65,512,417	44%	2013 Annual Report P. 82
Nanaimo, B.C.	83,810	\$ 131,411,642	\$ 10,882,914	8%	2013 Annual Report P. 28
Burnaby, B.C.	234,600	\$ 376,886,202	\$ 532,633,830	141%	2013 Annual Report P. 37 & 50
Whistler, B.C.	9,824	\$ 70,529,487	\$ 50,585,769	72%	2013 Annual Report P.42 & 58
District of Mission, B.C.	36,426	\$ 47,883,530	\$ 15,096,843	32%	2013 Annual Report P.23 & 48
Surrey, B.C.	501,100	\$ 655,326,000	\$ 85,131,000	13%	2013 Annual Report P. 20, 23, 50
Bellevue, WA	131,200	\$ 243,581,000	\$ 74,674,000	31%	2013 CAFR P.20
Portland, OR	603,000	\$ 1,071,898,392	\$ 363,709,535	34%	2013 CAFR P. 45 & 88

Exhibit G-2: General Reserve Balances - Comparison with Other Jurisdictions



This comparison pool was drawn mostly from other municipalities in British Columbia, with the addition of two nearby U.S. cities. The source of data was the annual report for each municipality. We excluded reserves and revenue from proprietary funds such as water or sewer utilities, but both operating and capital reserves are included.

The results show that the City of Victoria is at the upper end of the range when it comes to general reserves—the third highest out of the 12 cities surveyed. General reserves as a percentage of general revenues is a measure of conservatism in the municipalities' capital funding strategies as well as how well prepared they are for risks. With combined general operating and capital reserves equaling 60% of annual revenue, the City of Victoria is among the better-funded municipalities in the region.

H. SUMMARY OF RECOMMENDATIONS

Following is a summary of recommendations:

- Eliminate the Self Insurance and Working Capital funds and transfer their balances to the City Financial Stability Fund.
- Reclassify the Debt Reduction Fund with the Financial Stability reserves into a new category, Financial Management Reserves, and then eliminate the Fiscal Reserve Funds. (Requires change to Bylaw.)
- Establish and fund financial stability reserves for the water and sewer and, eventually, the stormwater utilities.
- Eliminate the City Strategic Initiatives Fund and transfer its remaining balances to the City Equipment Fund.
- Eliminate the Economic Development Fund and transfer its remaining balances to the Buildings and Infrastructure Fund. (Requires change to Bylaw.)
- Articulate in the Reserve Fund Policy the following target balances:
 - ◆ A target balance of 60 days of General Fund operating expenses for the Operating Financial Reserves (consisting of the City Financial Stability Reserve, Police Financial Stability Reserve, and Debt Reduction Reserve balances combined).
 - ◆ Separately, a target balance of 2% of Police operating budget expenses for the Police Financial Stability Reserve, as required by the agreement with the Police Board.
 - ◆ A target balance of 60 days of operating expenses for the Water Financial Stability Fund.
 - ◆ A target balance of 60 days of operating expenses for the Sewer Financial Stability Fund.
 - ◆ When the stormwater utility is created and begins generating operating revenue, a Stormwater Financial Stability Reserve should be created, with a target balance of 45 days of operating expenses.
 - ◆ For each of the financial stability reserves, the policy should state that any action taken that would reduce the fund balance below the target level must be accompanied by a replenishment plan. Under normal circumstances, the replenishment of the reserve should occur over no more than three years.
 - ◆ If the nature of the fiscal emergency is such that a multi-year drawdown from one of the financial stability reserves is necessary, the action should be accompanied by a drawdown plan that states how much of the reserve can be drawn on in any given year. The presumption in such a drawdown plan should be that no more than 50% of the reserve can be withdrawn in the first year, no more than 50% of the remaining balance

can be withdrawn in the second year, no more than 50% of the remaining balance can be withdrawn in the third year, and by the fourth year replenishment must begin.

- ◆ The Employee Benefit Obligation Reserves should have a target balance that is based on actuarial analysis of future obligations.
- ◆ The major capital reserves consist of reserve funds that are relied on for planned capital reinvestment in an assigned group of existing assets. For the major capital reserves, the target balance shall consist of a capital contingency, plus an amount sufficient to allow that fund's capital plan to be funded without requiring the use of debt. The capital contingency shall be based on the following percentages multiplied by the estimated current replacement cost of each fund's assigned assets, rounded off:
 - Police Vehicles, Equipment and Infrastructure Fund: 0.3% (or as required by the agreement with the Police Board)
 - City Equipment Fund: 0.3%
 - Vehicles and Heavy Equipment Fund: 0.3%
 - Buildings and Infrastructure Fund: 0.7%
 - Victoria Conference Centre Equipment and Infrastructure Fund: 0.5%
 - Parking Services Equipment and Infrastructure Fund: 0.3%
 - Save-On-Foods Memorial Center (SOFMC) Fund: 0.5%
 - Recreation Facilities Equipment and Infrastructure Fund: 0.5%
 - Water Utility Equipment and Infrastructure Fund: 0.3%
 - Sewer Utility Equipment and Infrastructure Fund: 0.3%
 - Stormwater Utility Equipment and Infrastructure Fund: 0.3%
- Capital plans or equipment/vehicle replacement schedules should be required to be maintained for each major capital fund and updated not less often than once every six years.
- The City should develop and implement a formal property acquisition strategy for the Tax Sale Lands Reserve and the Parks and Greenways Acquisition Reserve. A target balance should be developed for those two funds that is based on the amount of cash needed to take advantage of opportunities to acquire target properties, and that target reserve should be added to the Reserve Fund Policy. For the Parks and Greenways Acquisition Reserve, we suggest that the target reserve be defined as the cost of acquiring either 1.5 hectares of land, or sufficient land for three neighborhood parks in park-deficient areas. The property acquisition strategy for both funds should also identify the means of replenishment after fund balances are drawn down for a property acquisition.
- The other reserve funds shall not have a target balance.

APPENDIX A – ORIGINAL COST VS. REPLACEMENT COST

The following table shows the Engineering-News Record (ENR) Construction Cost Index 20-City Average for the years 1908 through 2014. This can be used to create a rough equivalence between the estimated current replacement cost of an asset and its original cost at the time it was placed in service. Depending on which type of data the City has more readily available and considers most reliable, data can either be converted from original cost to current replacement cost or from current replacement cost to original cost.

This conversion should be considered only a rough approximation. It can be used to help the City characterize the approximate level of investment in large numbers of assets, which can serve as the basis for the minimum capital contingency of a capital reserve fund. However, an up-to-date engineering assessment of the current replacement cost is always preferable as a basis for decisions about real capital expenditures.

Engineering News Record (ENR) 20 City Average Construction Cost Index (CCI)					
Year	ENR CCI (yearly avg)	Yearly Increase	Age (years)	Current Cost as Multiple of Original Cost	Original Cost as Percentage of Current Cost
1908	97	4.82%	106	101.10	0.99%
1909	91	-6.19%	105	107.77	0.93%
1910	96	5.49%	104	102.16	0.98%
1911	93	-3.13%	103	105.45	0.95%
1912	91	-2.15%	102	107.77	1%
1913	100	9.89%	101	98.07	1%
1914	89	-11.00%	100	110.19	1%
1915	93	4.49%	99	105.45	1%
1916	130	39.78%	98	75.44	1%
1917	181	39.23%	97	54.18	2%
1918	189	4.42%	96	51.89	2%
1919	198	4.76%	95	49.53	2%
1920	251	26.77%	94	39.07	3%
1921	202	-19.52%	93	48.55	2%
1922	174	-13.86%	92	56.36	2%
1923	214	22.99%	91	45.83	2%
1924	215	0.47%	90	45.61	2%
1925	207	-3.72%	89	47.38	2%
1926	208	0.48%	88	47.15	2%
1927	206	-0.96%	87	47.61	2%
1928	207	0.49%	86	47.38	2%
1929	207	0.00%	85	47.38	2%
1930	203	-1.93%	84	48.31	2%
1931	181	-10.84%	83	54.18	2%
1932	157	-13.26%	82	62.46	2%
1933	170	8.28%	81	57.69	2%
1934	198	16.47%	80	49.53	2%
1935	196	-1.01%	79	50.04	2%
1936	206	5.10%	78	47.61	2%
1937	235	14.08%	77	41.73	2%
1938	236	0.43%	76	41.56	2%
1939	236	0.00%	75	41.56	2%
1940	242	2.54%	74	40.52	2%
1941	258	6.61%	73	38.01	3%
1942	276	6.98%	72	35.53	3%
1943	290	5.07%	71	33.82	3%
1944	299	3.10%	70	32.80	3%
1945	308	3.01%	69	31.84	3%
1946	346	12.34%	68	28.34	4%
1947	413	19.36%	67	23.75	4%
1948	461	11.62%	66	21.27	5%
1949	477	3.47%	65	20.56	5%
1950	510	6.92%	64	19.23	5%
1951	543	6.47%	63	18.06	6%
1952	569	4.79%	62	17.24	6%
1953	600	5.45%	61	16.35	6%
1954	628	4.67%	60	15.62	6%
1955	660	5.10%	59	14.86	7%
1956	692	4.85%	58	14.17	7%
1957	724	4.62%	57	13.55	7%
1958	759	4.83%	56	12.92	8%
1959	797	5.01%	55	12.30	8%
1960	824	3.39%	54	11.90	8%

Engineering News Record (ENR) 20 City Average Construction Cost Index (CCI)					
Year	ENR CCI (yearly avg)	Yearly Increase	Age (years)	Current Cost as Multiple of Original Cost	Original Cost as Percentage of Current Cost
1961	847	2.79%	53	11.58	9%
1962	872	2.95%	52	11.25	9%
1963	901	3.33%	51	10.88	9%
1964	936	3.88%	50	10.48	10%
1965	971	3.74%	49	10.10	10%
1966	1019	4.94%	48	9.62	10%
1967	1074	5.40%	47	9.13	11%
1968	1155	7.54%	46	8.49	12%
1969	1269	9.87%	45	7.73	13%
1970	1381	8.83%	44	7.10	14%
1971	1581	14.48%	43	6.20	16%
1972	1753	10.88%	42	5.59	18%
1973	1895	8.10%	41	5.18	19%
1974	2020	6.60%	40	4.85	21%
1975	2212	9.50%	39	4.43	23%
1976	2401	8.54%	38	4.08	24%
1977	2576	7.29%	37	3.81	26%
1978	2776	7.76%	36	3.53	28%
1979	3003	8.18%	35	3.27	31%
1980	3237	7.79%	34	3.03	33%
1981	3535	9.21%	33	2.77	36%
1982	3825	8.20%	32	2.56	39%
1983	4066	6.30%	31	2.41	41%
1984	4146	1.97%	30	2.37	42%
1985	4195	1.18%	29	2.34	43%
1986	4295	2.38%	28	2.28	44%
1987	4406	2.58%	27	2.23	45%
1988	4519	2.56%	26	2.17	46%
1989	4615	2.12%	25	2.13	47%
1990	4732	2.54%	24	2.07	48%
1991	4835	2.18%	23	2.03	49%
1992	4985	3.10%	22	1.97	51%
1993	5210	4.51%	21	1.88	53%
1994	5408	3.80%	20	1.81	55%
1995	5471	1.16%	19	1.79	56%
1996	5620	2.72%	18	1.75	57%
1997	5825	3.65%	17	1.68	59%
1998	5920	1.63%	16	1.66	60%
1999	6060	2.36%	15	1.62	62%
2000	6221	2.66%	14	1.58	63%
2001	6342	1.95%	13	1.55	65%
2002	6538	3.09%	12	1.50	67%
2003	6695	2.40%	11	1.46	68%
2004	7115	6.27%	10	1.38	73%
2005	7446	4.65%	9	1.32	76%
2006	7751	4.10%	8	1.27	79%
2007	7967	2.79%	7	1.23	81%
2008	8310	4.31%	6	1.18	85%
2009	8570	3.13%	5	1.14	87%
2010	8802	2.71%	4	1.11	90%
2011	9070	3.04%	3	1.08	92%
2012	9308	2.62%	2	1.05	95%
2013	9547	2.57%	1	1.03	97%
2014	9807	2.72%	0	1.00	100%

APPENDIX B – GFOA STATEMENTS OF BEST PRACTICES

The Government Finance Officers Association (GFOA), the professional association for local government finance officials in Canada and the United States, has prepared Statements of Best Practices with the goal of guiding local governments in setting sound financial policies and practices.

The following three Statements of Best Practices are relevant to the question of target reserve balances:

- Determining the Appropriate Level of Unrestricted Fund Balance in the General Fund (October 2009)
- Replenishing General Fund Balance (February 2011)
- Determining the Appropriate Levels of Working Capital in Enterprise Funds (February 2011)

Following is the text of these three statements.



GFOA Best Practice

Determining the Appropriate Level of Unrestricted Fund Balance in the General Fund

Background. Accountants employ the term *fund balance* to describe the net assets of governmental funds calculated in accordance with generally accepted accounting principles (GAAP). Budget professionals commonly use this same term to describe the net assets of governmental funds calculated on a government's budgetary basis.¹ In both cases, fund balance is intended to serve as a measure of the financial resources available in a governmental fund.

Accountants distinguish up to five separate categories of fund balance, based on the extent to which the government is bound to honor constraints on the specific purposes for which amounts can be spent: *nonspendable fund balance*, *restricted fund balance*, *committed fund balance*, *assigned fund balance*, and *unassigned fund balance*.² The total of the last three categories, which include only resources without a constraint on spending or for which the constraint on spending is imposed by the government itself, is termed *unrestricted fund balance*.

It is essential that governments maintain adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates. Fund balance levels are a crucial consideration, too, in long-term financial planning.

In most cases, discussions of fund balance will properly focus on a government's general fund. Nonetheless, financial resources available in other funds should also be considered in assessing the adequacy of unrestricted fund balance (i.e., the total of the amounts reported as committed, assigned, and unassigned fund balance) in the general fund.

Credit rating agencies monitor levels of fund balance and unrestricted fund balance in a government's general fund to evaluate a government's continued creditworthiness. Likewise, laws and regulations often govern appropriate levels of fund balance and unrestricted fund balance for state and local governments.

Those interested primarily in a government's creditworthiness or economic condition (e.g., rating agencies) are likely to favor increased levels of fund balance. Opposing pressures often come from unions, taxpayers and citizens' groups, which may view high levels of fund balance as "excessive."

Recommendation. GFOA recommends that governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund.³ Such a guideline should be set by the appropriate policy body and should provide both a temporal framework and specific plans for increasing or decreasing the level of unrestricted fund balance, if it is inconsistent with that policy.⁴

The adequacy of unrestricted fund balance in the general fund should be assessed based upon a government's own specific circumstances. Nevertheless, GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.⁵ The choice of revenues or expenditures as a basis of comparison may be dictated by what is more predictable in a government's particular circumstances.⁶ Furthermore, a government's particular situation often may require a level of unrestricted fund balance in the general fund significantly in excess of this recommended minimum level. In any case, such measures should be applied within the context of long-term forecasting, thereby avoiding the risk of placing too much emphasis upon the level of unrestricted fund balance in the general fund at any one time.

In establishing a policy governing the level of unrestricted fund balance in the general fund, a government should consider a variety of factors, including:

- The predictability of its revenues and the volatility of its expenditures (i.e., higher levels of unrestricted fund balance may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile);
- Its perceived exposure to significant one-time outlays (e.g., disasters, immediate capital needs, state budget cuts);
- The potential drain upon general fund resources from other funds as well as the availability of resources in other funds (i.e., deficits in other funds may require that a higher level of unrestricted fund balance be maintained in the general fund, just as, the availability of resources in other funds may reduce the amount of unrestricted fund balance needed in the general fund);⁷
- Liquidity (i.e., a disparity between when financial resources actually become available to make payments and the average maturity of related liabilities may require that a higher level of resources be maintained); and
- Commitments and assignments (i.e., governments may wish to maintain higher levels of unrestricted fund balance to compensate for any portion of unrestricted fund balance already committed or assigned by the government for a specific purpose).

Furthermore, governments may deem it appropriate to exclude from consideration resources that have been committed or assigned to some other purpose and focus on unassigned fund balance rather than on unrestricted fund balance.

Naturally, any policy addressing desirable levels of unrestricted fund balance in the general fund should be in conformity with all applicable legal and regulatory

constraints. In this case in particular, it is essential that differences between GAAP fund balance and budgetary fund balance be fully appreciated by all interested parties.

Notes:

- 1 For the sake of clarity, this recommended practice uses the terms GAAP fund balance and budgetary fund balance to distinguish these two different uses of the same term.
- 2 These categories are set forth in Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which must be implemented for financial statements for periods ended June 30, 2011 and later.
- 3 Sometimes restricted fund balance includes resources available to finance items that typically would require the use of unrestricted fund balance (e.g., a contingency reserve). In that case, such amounts should be included as part of unrestricted fund balance for purposes of analysis.
- 4 See Recommended Practice 4.1 of the National Advisory Council on State and Local Budgeting governments on the need to "maintain a prudent level of financial resources to protect against reducing service levels or raising taxes and fees because of temporary revenue shortfalls or unpredicted one-time expenditures" (Recommended Practice 4.1).
- 5 In practice, a level of unrestricted fund balance significantly lower than the recommended minimum may be appropriate for states and America's largest governments (e.g., cities, counties, and school districts) because they often are in a better position to predict contingencies (for the same reason that an insurance company can more readily predict the number of accidents for a pool of 500,000 drivers than for a pool of fifty), and because their revenues and expenditures often are more diversified and thus potentially less subject to volatility.
- 6 In either case, unusual items that would distort trends (e.g., one-time revenues and expenditures) should be excluded, whereas recurring transfers should be included. Once the decision has been made to compare unrestricted fund balance to either revenues or expenditures, that decision should be followed consistently from period to period.
- 7 However, except as discussed in footnote 4, not to a level below the recommended minimum.

Approved by the GFOA's Executive Board, October, 2009.



GFOA Best Practice

Replenishing General Fund Balance

Background. It is essential that governments maintain adequate levels of fund balance to mitigate risks and provide a back-up for revenue shortfalls.

The adequacy of unrestricted fund balance¹ in the general fund should be assessed based upon a government's specific circumstances. Nevertheless, GFOA recommends, at a minimum, that general-purpose governments, regardless of size, incorporate in its financial policies that unrestricted fund balance in their general fund be no less than two months of regular general fund operating revenues or regular general fund operating expenditures.

If fund balance falls below a government's policy level, then it is important to have a solid plan to replenish fund balance levels. Rating agencies consider the government's fund balance policy, history of use of fund balance, and policy and practice of replenishment of fund balance when assigning ratings. Thus, a well developed and transparent strategy to replenish fund balance may reduce the cost of borrowing. However, it can be challenging to build fund balances back up to the recommended levels because of other financial needs and various political considerations.

Recommendation. GFOA recommends that governments adopt a formal fund balance policy that defines the appropriate level of fund balance target levels. Also, management should consider specifying the purposes for which various portions of the fund balances are intended. For example, one portion of the fund balance may be for working capital, one for budgetary stabilization, and one for responding to extreme events. This additional transparency helps decision makers understand the reason for maintaining the target levels described in the fund balance policy.

Governments should also consider providing broad guidance in their financial policies for how resources will be directed to fund balance replenishment. For example, a policy may define the revenue sources that would typically be looked to for replenishment of fund balance. This might include non-recurring revenues, budget surpluses, and excess resources in other funds (if legally permissible and if there is defensible rationale). Year-end surpluses are an especially appropriate source for replenishing fund balance.

Finally, a government should consider including in its financial policy a statement that establishes the broad strategic intent of replenishing fund balances as soon as

economic conditions allow. This emphasizes fund balance replenishment as a financial management priority.

Governments are subject to a number of factors that could require the use of fund balances. It is therefore incumbent on jurisdictions to minimize the use of fund balance, except in very specific circumstances. Replenishment should take place in a prompt fashion with amounts that have been used to ensure that the jurisdiction is properly prepared for contingencies. With the foundation of a financial policy in place, governments should use their long-term financial planning and budget processes to develop a more detailed strategy for using and replenishing fund balance. With these criteria in mind, the government should develop a replenishment strategy and timeline for replenishing fund balances as soon as possible, and that is still appropriate to prevailing budgetary and economic conditions and that considers the following:

1. The policy should define the time period within which and contingencies for which fund balances will be used. This gives the public a sense for how fund balance is being used as a “bridge” to ensure stable cash flow and provide service continuity.
2. The policy should describe how the government’s expenditure levels will be adjusted to match any new economic realities that are behind the use of fund balance as a financing bridge.
3. The policy should describe the time period over which the components of fund balance will be replenished and the means by which they will be replenished. Frequently, a key part of the replenishment plan will be to control operating expenditures and use budget surpluses to replenish fund balance. The replenishment plan might also specify any particular revenue source that will aid in the replenishment of fund balances. For example, if the government has a volatile sales tax yield, it might specify that yields that are significantly above average would be used to replenish fund balances.

Generally, governments should seek to replenish their fund balances within one to three years of use. However, when developing the specifics of the replenishment plan, governments should consider a number of factors that influence the rate and time period over which fund balances will be replenished. Factors influencing the replenishment time horizon include:

1. The budgetary reasons behind the fund balance targets. The government should consider special conditions that may have caused it to set its fund balance target levels higher than the GFOA-recommended minimum level. For example, if targets are higher because the community has very volatile cash flows, then the government would want to build the fund balances back up more quickly compared to governments with more stable cash flows.
2. Recovering from an extreme event. An extreme event, such as a natural disaster, that has required the government to use a portion of its fund balance, may make

it infeasible to replenish the fund balance as quickly as normal, depending upon the severity of the event.

3. Political continuity. Replenishing fund balance takes political will, and that will is often strengthened by the memory of the financial challenge that caused the use of fund balances in the first place. If the governing board and/or management are already committed to a particular financial policy, the replenishment strategy should be as consistent as possible with that policy in order to maximize political support.
4. Financial planning time horizons. Fund balances should typically be replenished within the time horizon covered by the organization's long-term financial plan. This puts the entire replenishment plan in context and shows the public and decision makers the expected positive outcome of the replenishment strategy.
5. Long-term forecasts and economic conditions. Expectations for poor economic conditions may delay the point at which fund balances can be replenished. However, in its replenishment plan the government should be sure to set a benchmark (e.g., after fund balances have dropped to a certain point below desired target levels) for when use of fund balance is no longer acceptable as a source of funds.
6. Milestones for gradual replenishment. A replenishment plan will likely be more successful if it establishes replenishment milestones at various time intervals. This is especially important if replenishment is expected to take place over multiple years (e.g., if you are starting from 75% of your target, set a goal to reach 80 percent of target in one year, 90 percent in two years, and 100 percent in three years).
7. External financing expectations. A replenishment plan that is not consistent with credit rating agency expectations may increase the government's cost of borrowing. It is important that the logic used by the government to develop the replenishment plan be communicated in an effective fashion to external lenders.

Notes:

- 1 Unrestricted fund balance comprises the committed, assigned, and unassigned fund balance categories.

References.

GFOA Best Practice, "Appropriate Level of Unrestricted Fund Balance in the General Fund," 2009.

For a fuller explanation of the concept of "bridging" in financial distress, please visit GFOA's financial recovery website at www.gfoa.org/financialrecovery.



GFOA Best Practice

Determining the Appropriate Levels of Working Capital in Enterprise Funds

Background. Enterprise funds distinguish between current and non-current assets and liabilities. It is possible to take advantage of this distinction to calculate working capital (i.e., current assets less current liabilities). The measure of working capital indicates the relatively liquid portion of total enterprise fund capital, which constitutes a margin or buffer for meeting obligations.

It is essential that a government maintain adequate levels of working capital in its enterprise funds to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenses) and to ensure stable services and fees.

Working capital is a crucial consideration, too, in long-term financial planning. Credit rating agencies consider the availability of working capital in their evaluations of continued creditworthiness. Likewise, laws and regulations may speak to appropriate levels of working capital for some enterprise funds.

Recommendation. GFOA recommends that local governments adopt a target amount of working capital to maintain in each of their enterprise funds. Ideally, targets would be formally described in a financial policy and/or financial plan.

GFOA recommends that governments use working capital as the measure of available margin or buffer in enterprise funds. Although as previously stated, working capital is defined as current assets minus current liabilities, government finance officers should be aware of certain characteristics of working capital that affect its use as a measure. Specifically, the “current assets” portion of working capital includes assets or resources that are reasonably expected to be realized in cash (e.g., accounts receivable) or consumed (e.g., inventories and prepaids) within a year, which leads to two considerations for an accurate calculation of working capital:

- **Strength of collection practices.** An appropriate allowance for uncollectibles should be established and the amount of the receivable that is expected to be collected in cash within one year should be determined in a manner that is consistent with the collection practices of the government. If the accounts receivable collection practices of the enterprise fund are inconsistent or weak, then less of the accounts receivable amount should be reported as current assets.
- **Historical consumption of inventories and prepaids.** The amount of inventories and prepaids included in current assets should be a realistic

estimate of the amount that will be consumed in one year based on a historical usage pattern and current operating levels (inventories) or based on the time periods to which the items relate (prepaids).

Because the purposes, customers, and other characteristics of enterprise funds can vary widely, GFOA recommends that governments develop a target amount of working capital that best fits local conditions for each fund. However, GFOA recommends that under no circumstances should the target for working capital be less than forty-five (45) days worth of annual operating expenses¹ and other working capital needs of the enterprise fund.* A target of 45-days would only be appropriate for those enterprise funds with the least amount of need for cushion or buffer.

In order to arrive at a customized target amount of working capital, governments should start with a baseline of ninety (90) days worth of working capital and then adjust the target based on the particular characteristics of the enterprise fund in question (using 45 days as the minimum acceptable level). The primary characteristics to think about when customizing a working capital target are presented below. The appendix to this Best Practices provides more detailed considerations for these characteristics as they pertain to common types of government enterprise funds.

- Support from general government. Some enterprise funds may be supported by general taxes or transfers from a general government. These enterprise funds may require lower levels of working capital if they are supported by these contributors. For a heavily subsidized enterprise fund the 45-day minimum working capital recommendation contained in this Best Practice might be met through support from the general government, if a financial buffer or cushion for the enterprise fund is to be provided by the general government (or other outside contributor).
- Transfers out. If the enterprise fund is expected to make a transfer to the general government or to some other fund, then this sort of claim on the enterprise fund's assets may call for higher levels of working capital to maintain flexibility. Transfers could include an enterprise fund's contributions to overhead/support functions, subsidies granted to other operations, or any other transfer of resources. Regardless of the rationale of the transfer, governments should take into account the claim on working capital when setting a target amount.
- Cash cycles. Does the enterprise fund experience large peaks and valleys in its cash position during the year? For example, a water enterprise fund may experience significantly higher levels of cash on hand during the summer months compared to the winter. Volatile cash cycles call for higher levels of working capital. Another consideration is the length of the billing cycle. A longer billing cycle would call for higher levels of working capital because the enterprise fund will have longer durations between major infusions of cash.
- Customer concentration. Is the enterprise fund dependent on a few customers for a large portion of its revenues or is the customer base diversified? For example, a port enterprise fund may be dependent on a few major shippers or commerce in a niche product. Lower customer

concentration may mean that the enterprise fund can safely operate with lower levels of working capital.

- Demand for services. Does the enterprise fund face a steady demand for service or is demand potentially volatile, thereby leading to volatility in of income? For example, the demand for utility services is steady compared to demand for air travel. Also consider the impact of competitive position on demand. Direct competitors or the availability of reasonable substitutes could lead to greater volatility in demand for the enterprise fund's services. More volatility implies greater need for working capital margins.
- Control over rates and revenues. Does the enterprise fund have the ability to change rates, implement new charges, or otherwise raise revenues from its customers in a simple fashion? For example, transit enterprise funds are often constrained from raising rates by political pressure. Other enterprise funds may be subject to a rate control board. Those that face competitors in their market may have less effective control over their rates and revenues. More revenue constrained enterprise funds may need higher levels of working capital.
- Asset age and condition. What is the age and condition of the enterprise fund's infrastructure? Older infrastructure has greater exposure to extraordinary repair needs. Enterprise funds with newer and/or well maintained capital assets may be able to operate with less working capital than other enterprise funds.
- Volatility of expenses. Are the expenses of the enterprise fund volatile or does the enterprise fund have a high degree of control over its expenses? For example, the expenses of a solid waste enterprise fund tend to be fairly stable throughout the year. In another example, water or sewer enterprise funds may be more vulnerable to large expense spikes from extreme weather. Enterprise funds with more stable expenses can safely operate with less working capital than other enterprise funds.
- Control over expenses. Consider the enterprise fund's level of fixed and variable costs and the ability to reduce variable costs in response to lower revenues. For instance, if a convention center does not book an event, it does not need to hire temporary help and incur other expenditures in support of the event. An enterprise fund with a high percentage of operational costs which vary depending upon revenues or operating levels may operate with lower levels of working capital.
- Management plans for working capital. Working capital includes assets, which can include both truly unrestricted resources and resources that have internal limitations placed upon them (e.g., board-designated) and/or that may be committed for future capital spending. These amounts may appear as unrestricted on the balance sheet but, in actuality, may be unavailable in the future to serve as a buffer or tool to help manage financial risk. If these types of limitations exist, the working capital target should be adjusted to arrive at an amount that represents a true amount available as a tool to manage financial risk.
- Separate targets for operating and capital needs. Depending on the nature of the enterprise fund, governments might also consider designating separate targets for operating and capital needs, especially when the enterprise fund is very capital intensive. For example, there might be a separate amount identified for equipment replacement or debt service. In such a case, targets

should be separately evaluated based on the particular features of the isolated amounts.

- Debt position. Enterprise funds often carry significant amounts of debt, which is used to acquire capital assets. The amount and type of debt an enterprise fund carries can have important ramifications for working capital targets. For example, an enterprise fund with a large amount of variable rate debt may need additional buffer to manage the risk associated with interest rate volatility. In addition, uneven and increasing or lump-sum debt principal payments to be made in future years may raise the amount of working capital that the enterprise fund should maintain. Viewing the amount of working capital in this broader context will help ensure that resources are available to make debt payments as they come due.

Notes:

- 1 The recommendation is to use annual operating expenses which include depreciation expense. If, however, annual depreciation expense is significantly more or less than the anticipated capital outlays of the next period to be paid from working capital consideration should be given to adjusting the benchmark. An appropriate adjusted benchmark may be annual operating expenses - annual depreciation expense + capital outlays of the next period to be paid from working capital.

* Subject to the exception for heavily subsidized enterprises, described later in this Best Practice.

Approved by the GFOA's Executive Board, February, 2011.

Appendix E – Recommended Target Balance Methodology

Fund Description	Primary Purpose	Target Balance?	Recommended Basis for Target Balance
Financial Stability			
City Financial Stability Insurance Debt Reduction	Risk mitigation	Yes	60 days (16.67%) of General Operating expenses
Police Financial Stability	Risk mitigation	Yes	Per agreement (2% of operating expenses)
Water Utility Financial Stability	Risk mitigation	Yes	60 days (16.67%) of operating expenses
Sewer Utility Financial Stability	Risk mitigation	Yes	60 days (16.67%) of operating expenses
Stormwater Utility Financial Stability	Risk mitigation	Yes	45 days (12.5%) of operating expenses
Equipment and Infrastructure			
Police Vehicles, Equipment and Infrastructure	Planned capital funding	Yes	Minimum of 0.3% of replacement cost, plus funding of replacement schedule, subject to agreement
Emergency Response Team Vehicles/Equipment	Dedicated revenue source	No	No target balance
City Equipment Archives Equipment Strategic Planning Initiatives	Planned capital funding Dedicated revenue source Dedicated revenue source	Yes No No	Minimum 0.3% of replacement cost, plus funding of replacement schedule
City Vehicles and Heavy Equipment	Planned capital funding	Yes	Minimum 0.3% of replacement cost, plus funding of replacement schedule
VCC Equipment and Infrastructure	Planned capital funding	Yes	Minimum 0.5% of replacement cost, plus funding of capital program
City Buildings and Infrastructure	Planned capital funding	Yes	Minimum 0.7% of replacement cost, plus funding of capital program
Parking Services Equipment and Infrastructure	Planned capital funding	Yes	Minimum 0.3% of replacement cost, plus funding of capital program
Multipurpose Equipment and Infrastructure	Planned capital funding	Yes	Minimum 0.5% of replacement cost, plus funding of capital program
Recreation Facilities Equipment and Infrastructure Artificial Turf Field (Topaz Park)	Planned capital funding/Dedicated funding source	Yes No	Minimum 0.5% of replacement cost, plus funding of capital program No target balance
Gas Tax	Dedicated funding source	No	No target balance
Water Utility Equipment and Infrastructure	Planned capital funding	Yes	Minimum 0.3% of replacement cost, plus funding of capital program
Sewer Utility Equipment and Infrastructure	Planned capital funding	Yes	Minimum 0.3% of replacement cost, plus funding of capital program
Stormwater Utility Equipment and Infrastructure	Planned capital funding	Yes	Minimum 0.3% of replacement cost, plus funding of capital program
Employee Benefit Obligations			
Police Retirement Benefits	Planned future obligations	Yes	As determined by actuarial analysis
Police Employee Pension Buybacks	Planned future obligations	Yes	As determined by actuarial analysis
Police Pension Corporation Over Contributions	Planned future obligations	Yes	As determined by actuarial analysis
City Retirement Benefits	Planned future obligations	Yes	As determined by actuarial analysis
City Employee Pension Buybacks	Planned future obligations	Yes	As determined by actuarial analysis
Fire Pension Corporation Over Contributions	Planned future obligations	Yes	As determined by actuarial analysis
Economic Development			
Development Cost Charges	Dedicated revenue source	No	No target balance
Tax Sale Lands	Planned capital funding	Yes	Based on acquisition strategy
Parks and Greenways Acquisition	Planned capital funding	Yes	Based on acquisition strategy
Local Amenities	Dedicated revenue source		No target balance
Victoria Housing Dockside Affordable Housing	Dedicated revenue source Dedicated revenue source		No target balance No target balance
Climate Action	Dedicated revenue source		No target balance
Art in Public Places	Dedicated revenue source		No target balance
Downtown Core Area Public Realm Improvements	Dedicated revenue source		No target balance
Heritage Buildings Seismic Upgrades	Dedicated revenue source		No target balance