CITY OF VAUGHAN

EXTRACT FROM COUNCIL MEETING MINUTES OF DECEMBER 10, 2013

Item 2, Report No. 15, of the Finance and Administration Committee, which was adopted without amendment by the Council of the City of Vaughan on December 10, 2013.

2 IMPACT OF BUDGETING FOR AMORTIZATION AND POST-EMPLOYMENT EXPENSES – 2014 BUDGET

The Finance and Administration Committee recommends approval of the recommendation contained in the following report of the Acting Commissioner of Finance & City Treasurer, dated November 18, 2013:

Recommendation

The Acting Commissioner of Finance & City Treasurer recommends:

1. That the following report on the impact of budgeting for amortization and post-employment expenses be received for information purposes.

Contribution to Sustainability

Financial sustainability is defined as the enduring ability of the City to ensure that it can deliver the level and types of programs to the community, while proactively managing associated risks, at acceptable levels of taxation and fees. The City of Vaughan has approximately 2.9 billion dollars in community infrastructure, which will require eventual replacement. Comparing Vaughan's future infrastructure replacement funding levels with Public Sector Accounting Board (PSAB) standards aims to provide insight into the City's ability to sustain the community's overall quality of life and the economic health for future generations.

Economic Impact

This report is for information and educational purposes only and there are no economic impacts.

However, the Financial Master Plan identifies an Infrastructure Funding as a key priority. To begin to address the forecasted capital asset renewal funding gap, the City has implemented several initiatives. For example, developing a consolidated reserve policy, realigning reserve balances, and the adoption of life cycle based contributions for new assets. These initiatives are positioned to address the need on a go forward basis. However, future funding will be required to address the backlog and/or prior contribution deficiencies. In addition to the above the City recently embarked on a Corporate-wide asset management initiative to better understand the condition of the City's assets and timing of maintenance, repair and replacement requirements. This information will paint a clearer picture of the financial requirements and timing to sustain the community's infrastructure network.

Communications Plan

The impact of infrastructure amortization and post-employment benefit expenses are disclosed on the City of Vaughan annual consolidated financial statements, as required under the new Public Sector Accounting Board (PSAB) standards.

Purpose

To provide Council with a report highlighting the impact of excluding infrastructure amortization and post-employment benefit expenses in the City's Budgets, as per Ontario Regulation 284/09.

Regulation 284/09 of the Municipal Act allows a municipality to exclude infrastructure amortization expenses, post-employment benefit expenses and solid waste landfill closure and post-closure expenses from the annual budget estimates, as long as Council is advised of the excluded expenses.

This report also serves as another opportunity to educate ratepayers regarding the costs of community infrastructure and the need to for further investment. Without additional infrastructure investment, there is a risk that Vaughan's infrastructure network will deteriorate, potentially compromising community health, safety, and service levels. Addressing the infrastructure replacement funding gap will take time and a decision to fund these future-oriented expenses will impact tax rates and/or user fees.

Background - Analysis and Options

Legislation Requirements

Historically, Ontario municipalities were not required to budget for amortization, but instead budgeted for contributions to capital reserves based on community affordability. Amortization reflects the annual theoretical consumption or utilization cost of an asset or liability over time. As a result, most Ontario municipalities, including Vaughan, have experienced a large gap between actual infrastructure and post retirement funding, and theoretical funding levels resulting from amortization expense calculations.

As a result, the Public Sector Accounting Board (PSAB) enacted a new standard (Standard 3150) in 2009, which requires the inclusion of capital asset historical values, accumulated amortization and annual amortization expenses as part of annual financial statement reporting.

In addition, the Province of Ontario enacted Municipal Act Regulation 284/09 "Budget Matters – Expenses", which states that municipalities may exclude from annual budgets all or a portion of expenses for infrastructure amortization, post-employment benefit expenses and solid waste landfill closure and post-closure expenses, as long as the exclusions are disclosed to and adopted by Council before the budget is approved. It should be noted, solid waste landfill closure and post closure expenses are not applicable to Vaughan. The following reporting directions are provided within the regulation:

1. An estimate of the change in the accumulated surplus of the municipality at the end of the year resulting from the exclusion of any of the expenses listed.

2. An analysis of the estimated impact of the exclusion of any of the expenses listed on the future tangible capital asset funding requirements of the municipality.

City Budgets

It should be noted, there is a very significant difference between the City's budget and financial reporting. The Budget is intended to illustrate funding requirements and sets the levy and tax rate, while financial statements are developed primarily for comparison and based on accounting principles and regulations. The City of Vaughan has developed its 2014 Budget excluding the full amortization for infrastructure assets and post-employment benefits. It should be noted; matching the budget contributions to amortization without alternative funding would significantly impact the tax rate and levy requirements. For illustration purposes, the estimated 2013 amortization expense can theoretically be compared to current annual budgeted reserve contributions and associated debt financing.

<u>Infrastructure Assets</u> - One challenge with this comparison, particularly with infrastructure, is amortization is based on historical cost equally allocated over the asset's estimated life, whereas renewal contributions and debt financing are more aligned with forecasted replacement costs, future capital spending requirements, asset condition assessments, available grant programs, etc. Therefore, the reported difference is likely conservative.

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Post-Employment Benefits – These are certain health, dental and life insurance benefits that will be paid by the City on behalf of its retired employees. The projected benefit obligation and the annual expense required to fully fund the obligation for active employees and retirees is recognized and reflected in the City's annual financial statements, but is not fully funded through the City's 2014 Budgets.

Estimate of the Change in Accumulated Surplus

The difference between estimated amortization expense and annual funding contributions are illustrated in the chart below:

Funding vs. Amortization (In Millions)	Annual Budget Funding**	Estimated 2013 Amortization	Gap
Asset Renewal			
City Operations*	23.1	44.1	21.0
Water/Wastewater	12.4	18.3	5.9
	35.5	62.4	26.9
Post Employment Benefits	1.3	12.5	11.2
Combined	36.8	74.9	38.1

**-City operations annual budget funding includes capital contributions and related debenture financing.*

***-The City's 2014 Water & Wastewater budgets are still in development and the City Operations figure is based on the Draft 2014 Operating Budget. Therefore, the above annual budget figures should be treated as estimates.*

As illustrated above, the annual gap between amortization and funding contributions is approximately $40 million. Funding this difference would impact on both the tax rate and water/waster water consumption rates. Budgeting for the full amortization expense would decrease the City's reported accumulated surplus by approximately $40 million.

Prudent asset management principles suggest that, at minimum, annual contributions to the capital program for asset replacement should be at least equivalent to historical amortization expense, the annual consumption or utilization expense of an asset. However, alternative choices are available, but typically not as stable or cost effective i.e. fund when required, issue debentures as needed, etc.

Municipal Leadership and City Actions

The City has a long standing dedication to financial management and has demonstrated financial leadership through progressive best practices and prudent financial policies. The need for future based planning was recognized by the City as early as 1994. As a result, the City recognized very early on there was a need to dynamically and proactively manage the growing infrastructure and post retirement benefit funding gap. Recently, the City has undertaken the following actions:

1. Multi-Year Budgeting – To provide visibility regarding future financial requirements.
2. Asset Management – The City is in the process of completing Phase I of the asset management initiative. At the September 16th Priorities and Key Initiatives Committee, staff presented the *Corporate Asset Management Strategy* report. Phase I is anticipated to be complete by year end 2013, and the current draft capital and operating budgets contain proposed projects and Additional Resource Requests to continue into Phase II of this initiative.

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3. Infrastructure Renewal Policy – To ensure annual replacement contributions are in place for new capital projects based on lifecycle principles commencing in the year of approval. This action spreads the cost across citizen generations and smoothes requests over time preventing large future unfunded expense spikes.
4. Reserve Policy Update – This action incorporated a realignment of reserve balances and expansion of surplus allocation to support infrastructure.
5. Financial Master Plan – The City's Financial Master Plan earmarked infrastructure funding as a top priority.

The above actions are designed to guide the municipality towards financial sustainability and are required to ensure the City is able to safeguard the community's infrastructure network, overall quality of life and the economic health for future generations.

Relationship to Vaughan Vision 2020

This report supports the City's organizational excellence strategic goal and relates specifically to the "Manage Corporate Assets" and "Ensure Financial Sustainability" strategic themes.

Regional Implications

Not applicable

Conclusion

This report provides the information necessary to provide disclosure under Ontario regulation 284/09 that requires municipalities to report to Council when certain expenses are excluded from the budget and the impact on the overall accumulated surplus of such transactions.

As indicated in the above detail, the City is experiencing a gap between amortization and budgeted contributions for both infrastructure and post-retirement benefits, as are most municipalities in Ontario

This challenge was recognized very early on by the City and actions are in motion to proactively and dynamically manage the growing funding gap. However, it is recognized that addressing the infrastructure replacement funding gap will take time and any decision to fund these future-oriented expenses will impact tax rates and/or user fees.

Attachments

N/A

Report prepared by

Jackie Lee Macchiusi, CGA
Manager, Capital & Reserve Planning

IMPACT OF BUDGETING FOR AMORTIZATION AND POST-EMPLOYMENT EXPENSES – 2014 BUDGET

Recommendation

The Acting Commissioner of Finance & City Treasurer recommends:

1. That the following report on the impact of budgeting for amortization and post-employment expenses be received for information purposes.

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Economic Impact

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However, the Financial Master Plan identifies an Infrastructure Funding as a key priority. To begin to address the forecasted capital asset renewal funding gap, the City has implemented several initiatives. For example, developing a consolidated reserve policy, realigning reserve balances, and the adoption of life cycle based contributions for new assets. These initiatives are positioned to address the need on a go forward basis. However, future funding will be required to address the backlog and/or prior contribution deficiencies. In addition to the above the City recently embarked on a Corporate-wide asset management initiative to better understand the condition of the City's assets and timing of maintenance, repair and replacement requirements. This information will paint a clearer picture of the financial requirements and timing to sustain the community's infrastructure network.

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Regulation 284/09 of the Municipal Act allows a municipality to exclude infrastructure amortization expenses, post-employment benefit expenses and solid waste landfill closure and post-closure expenses from the annual budget estimates, as long as Council is advised of the excluded expenses.

This report also serves as another opportunity to educate ratepayers regarding the costs of community infrastructure and the need to for further investment. Without additional infrastructure investment, there is a risk that Vaughan's infrastructure network will deteriorate, potentially compromising community health, safety, and service levels. Addressing the infrastructure replacement funding gap will take time and a decision to fund these future-oriented expenses will impact tax rates and/or user fees.

<u>Background - Analysis and Options</u>

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Attachments

N/A

Report prepared by

Jackie Lee Macchiusi, CGA
Manager, Capital & Reserve Planning

Respectfully submitted,

John Henry, CMA
Acting Commissioner of Finance/City Treasurer