

The Corporation of the Town of Lakeshore

Report to Council

Finance Services

Financial Analysis



To: Mayor & Members of Council

From: Adam Boylan, Manager of Financial Analysis

Date: June 2, 2020

Subject: 2019 Year End Results - 4th Quarter Variances

Recommendation

1. Approve the taxation supported surplus of \$1,229,687 for the year ended December 31, 2019 to be transferred to the Working Funds Reserve;
2. Approve the establishment of a Legal Services Reserve and a transfer to this reserve of \$96,622 representing the 2019 surplus in the Legal expense account budget;
3. Approve a transfer of \$194,286 from Building Services – Operating reserve fund to transfer the 2019 Accumulated Net Surplus per the draft 2019 Building Services Statement;
4. That the Wastewater (sanitary sewer) deficit of (\$372,874) for the year ended December 31, 2019 be funded by a transfer from the Wastewater (Sanitary Sewer) Reserve Fund; and,
5. That the Water deficit of (\$486,901) for the year ended December 31, 2019 be funded by a transfer from the Water Reserve Fund.

Background

Annual operating budgets for all budget centers are set at the beginning of the calendar year based on Council direction and strategic priorities. Professional estimates, current trends, legislative environment, and other local information available at the time are significant inputs to the operating budgets recommended to Council. Revenues and expenditures are monitored on an ongoing basis and projected through to the end of the year to ensure they remain at or as close to their approved budget as possible and that all material variances are mitigated as effectively as possible.

Financial results as at December 31, 2019 (4th quarter) have been reviewed and the resulting cumulative surplus/(deficits) have been determined accordingly. This report

provides variances from the approved budgets for taxation, water and wastewater rate funded budget centres for the 2019 fiscal year.

Comments

Taxation Supported Results:

The 2019 fiscal year ended with cumulative municipal surplus of \$1,229,687 for taxation supported budget centers. The departmental that resulted in the net surplus are outlined in **Appendix A** as attached.

The main elements comprising the net surplus are outlined below. The majority of the surplus is being driven by revenue surpluses that were not anticipated at the time of preparing the 2019 Budget.

Category	Surplus (Deficit)
Investment Income	549,190
Wages and Benefits	535,700
Supplementary Tax Revenue	221,660
Payments in Lieu	212,660
Interest on Late Accounts	54,560
Revenue from Provincial Offences	79,930
Other Miscellaneous Items	12,457
Facility Repairs	(102,150)
Vehicle & Equipment Repairs	(160,740)
Capital Project Overexpenditures	(173,580)
2019 Cumulative Surplus	1,229,687

Interest rates remained high throughout 2019 which yielded favourable results for the Town's investments. The Town entered the year with a healthy cash balance and, coupled with a late start to the construction season, generated a \$549,190 surplus in this line item. This represents a 37% increase from the prior year. With interest rates falling in 2020 due to the COVID-19 pandemic it is expected the Town's return on investments will not fare as well in 2020. Given the volatility of this account, investment income is budgeted using conservative estimates to mitigate the impact of potential fluctuations in interest rates on the overall municipal budget.

From a staffing perspective, 2019 was a year of significant change for the Town. A number of positions were vacant for all or part of the year for a variety of reasons which include timing of recruitment, restructuring of positions, staff turnover, leave of absences and retirements. Due to the impact of these contributing circumstances, the Town incurred an overall savings of \$535,700 in wages and benefits.

Supplementary tax revenue is generated throughout the year by newly created properties and properties that have had physical alterations made that were not reflected on the return of the roll provided by MPAC in December of the previous year. The Town had another strong year for supplementary tax revenue in 2019 generating \$920,000 in additional tax revenue, exceeding budget expectations by \$221,660. Supplementary tax revenue generation has been strong since 2016 and reached a historic high of \$1.13 million in 2018.

Surpluses in other revenue line items such as revenues generated from payments in lieu of taxes, revenue from penalties and interest on taxes and other fee based revenue such as revenue from Provincial Offences fines, have also been recognized in the year contributing to the overall surplus.

Other miscellaneous items resulted in an overall savings of \$12,457 in 2019.

As expressed in the 2019 Draft Budget report, facilities, fleet and major equipment replacement have become key areas of concern from both an operational and financial perspective. The Town's facilities and equipment are aging and have become increasingly costly to maintain which has in part resulted in over expenditures of (\$102,150) and (\$160,740) in equipment and facility repair allowances respectively in 2019. Repairs at ATC, Town Hall and the Comber Medical Centre contribute to the majority of the facility related over expenditures. Past deferral of asset replacements enabled the Town to avoid costly short-term replacement costs and focus on other areas of its capital program, but the results of this strategy have put significant pressure on operating budgets. As part of a multi-year financial strategy to combat this issue, Council approved additional base contributions to reserves in both the 2019 and 2020 budgets to allow for greater ability to replace these assets at a more financially optimal point in their lifecycle. As older assets continue to be replaced, there is an expectation that operating repairs and maintenance allowances can be more easily managed.

Budgets for capital projects are best estimates based on all relevant information at the time of budget preparation. Given these estimates are high level, there is a risk that actual project costs may exceed these estimates for various reasons. In 2019, there were a few capital projects funded from taxation, which ended the year in a deficit position offsetting the overall year end surplus. The projects contributing to the Town's 2019 capital deficit of (\$174,000) are, the Marina dock replacements of (\$37,500), collective road rehabilitation works of (\$47,300), optimist park equipment replacement of (\$29,300) parking lot asphalt paving of (\$35,800), park trail replacements of (\$7,300) and other minor capital variances of (\$16,800). This variance represents 0.84% of the overall capital budget of \$20.6M in 2019. To mitigate the impact of capital variances on the overall operating budget, beginning in 2020 all capital projects will be funded from reserves.

There are quite a few projects that were not completed in 2019 and were carried over in 2020 as encumbrances. These are presented on **Appendix D**. This is a change in the accounting for uncompleted projects than has been done in previous years. In prior years, during budget, Managers would provide Finance with best estimates of project budgets that needed to be carried over to the following year. These amount would be included into the next year's budget. Given the timing of when the budget was approved, these

estimates were not always reflective of the true costs needed in future years. Under approved accounting rules, encumbrances can be used to carry over any unspent budget dollars earmarked to complete projects in future years. Upon completion of a project, any surplus funding will be returned to the reserve. Should projects require additional funding due to unanticipated costs, a report will be brought to Council for approval.

Building Operations

Annual building permit collections amounted to \$705,000, representing approximately 66% of permit revenue incurred in 2018, the lowest annual total since 2014. Due to the cyclical nature of development, the Building Code Act mandates municipalities to transfer annual Building related surpluses to reserves so that in underperforming years, that reserve may be drawn upon to cover deficits. With 2019 being an underperforming year, it is recommended the Building Operating Reserve Fund be drawn upon in the amount of (\$194,286) to cover the overall deficit in this area. Despite this unfavourable result, the Town is well-protected against potential future Building related deficits as its Building Operating Reserve Fund has accumulated nearly \$1.5 million due to surpluses gained in recent years.

Legal Services Reserve

Administration is recommending the establishment of a Legal Services Reserve account that will provide for future unexpected legal costs that may be incurred in any given year. In some cases, those costs can be extremely high. The intent of this reserve is similar to that of the Building Operations Reserve. It is extremely difficult to predict in any given year what the Town may incur in legal fees. This Legal Services Reserve would assist in managing any unanticipated expenses and mitigate the overall impact to the annual budget. Any year end surpluses would be transferred to the reserve thereby creating a funding source should the Town experience unanticipated legal expenses in a given year. In 2019 the Legal expense account ended the year with a surplus of \$96,622. These recommendations support Council's strategic priority of Financial Sustainability.

User Rate Supported Results:

Wastewater (Sanitary Sewage)

The wastewater budget centre ended the 2019 year with a net deficit of (\$372,874). Revenue, expenditure and reserve transfer variances that resulted in the net deficit are outlined in **Appendix B** as attached.

Consumption in this area continues to increase likely as a result of new accounts being added annually. Despite a small revenue surplus of \$48,693 the Wastewater Division incurred an overall deficit. Offsetting the deficit is an unbudgeted grant of \$552,474 received through the Clean Water Wastewater Fund (CWWF) grant to fund the Town's Oakwood Sanitary Sewer and Stoney Point Plant Design projects. In accordance with the Town's CWWF funding agreement, this funding is transferred to reserves to offset the actual expenditures.

The division's Repairs and Maintenance budget which serves as an allowance account for significant capital costs that arise throughout the year incurred a deficit of (\$122,993) primarily due to inflow and infiltration work that was deferred from 2018 where the Town had a surplus on this line item. A number of unanticipated capital project costs in wastewater resulted in an over expenditure of (\$256,978) which consisted primarily of the Stoney Point Plant design which incurred costs in excess of the grant. This over expenditure was partially offset by savings in consulting services. Lastly, the Town's (\$86,168) deficit in "other operating costs", displayed on Appendix B, can be mostly attributed to property tax reassessments of Wastewater facilities.

Water

The 2019 fiscal year ended with a net deficit of approximately (\$486,901) for the water rate supported budget center. Revenue, expenditure and reserve transfer variances that result in a net deficit are outlined in **Appendix C** as attached.

Unlike the surplus experienced in wastewater, Water revenue collections underperformed in 2019 resulting in an overall revenue shortfall of (\$25,940). This can be partially attributed to the unusually wet year that 2019 was. A number of unanticipated capital project costs related to repairs and maintenance work were required in the year resulting in an over expenditure of (\$182,558). Significant contributing projects include: Rourke Line Water main Replacement, Water Meter Replacement Program and Elmstead Water main Replacement. In 2019, the Town received notice of retroactive re-assessments for our Water facilities. Since the Town allocates property taxes to these facilities, an adjustment to the payment in lieu tax account was processed, thereby contributing to the deficit of (\$253,064) in the "other operating expenses" category on Appendix C. Also contributing to the deficit were higher than expected insurance related costs, operating supplies, and equipment maintenance. Offsetting the overall deficit are wage related savings of \$160,548 from staff being off on medical leave for extended periods.

Financial Impacts

Taxation Supported Results:

In accordance with the current Reserve and Reserve Fund Policy FN-389, the working funds reserve fund has been underfunded for several years. The intent of this reserve is to fund day to day operations, maintain general cash flow and ensure business continuity during unforeseen events that may strain financial resources. The recommended target for this reserve is 2 months of operating costs or approximately \$7.5M. As evident with the unanticipated financial constraints the Town is experiencing from the effects of the COVID-19 pandemic, the value of adequately funding the Working Fund Reserves has never been more apparent. In alignment with Council's strategic priority of financial sustainability, it is recommended the 2019 surplus of \$1,229,678 be transferred to the Working Funds Reserve. This would increase the current uncommitted balance in the Working Fund Reserve to \$2,872,700. As part of the reserve fund policy, this reserve should contain funding to cover at a minimum 2 months of operating costs. The annual operating budget is approximately \$45M. Two months of funding would equate to \$7.5M.

In addition, in accordance with the reserve fund policy, a transfer of \$194,286 will be made from the Building Operating reserve fund based on the 2019 Accumulated Net Deficit for Building.

Administration is also recommending the establishment of a Legal Services reserve with a transfer of \$96,622 in 2019.

User Rate Supported Results:

User rate supported deficits are recommended to be funded from the Water Reserve Fund and Wastewater Reserve Fund respectively. Administration will continue to develop the Town's financing strategy to best mitigate the impact on rate payers.

Attachment(s): Appendix A – 2019 Taxation Funded Variance Summary
Appendix B – 2019 Wastewater Rate Funded Variance
Appendix C – 2019 Water Rate Funded Variance
Appendix D – 2019 Encumbrances

Report Approval Details

Document Title:	2019 Year End Results - 4th Quarter Variance.docx
Attachments:	- Appendix A - 2019 Taxation Funded Variance Summary.pdf - Appendix B - 2019 Wastewater Rate Funded Variance.pdf - Appendix C - 2019 Water Rate Funded Variance.pdf - Appendix D - 2019 Encumbrances.pdf
Final Approval Date:	Jun 3, 2020

This report and all of its attachments were approved and signed as outlined below:

Rosanna Pellerito

Kristen Newman

Truper McBride