

Memo



Date: April 25, 2023
File: 0605-01
To: Audit Committee
From: Divisional Director, Financial Services
Subject: Audit Committee Review of 2022 Surplus and Reserves
Report Prepared by: Financial Planning Manager

2022 Surplus

The 2022 fiscal year ended with a surplus of \$15.1M, made up of the General, Airport (after contributions to reserve), Water Utility and Wastewater Utility Fund surpluses. This surplus is calculated based on the 2022 amended budget. As part of regular operations, the Financial Services Division prepares an annual report detailing expenditures that have exceeded approved budget. This report, recommending approval of amendment no. 1 to the Five-Year Financial Plan 2022-2026 Bylaw along with details reflecting the necessity for the amendment, was forwarded to Council at the April 17, 2023 regular meeting.

The General Fund makes up the majority of this surplus at \$12.0M. This surplus is being recommended to be allocated to reserve and accumulated surplus as part of the City Manager's April 25, 2023 memorandum titled "2022 Surplus from Operations". After the distribution of this surplus, the general fund's accumulated surplus will be \$5.0M which represents 3% of the 2022 taxation demand.

Major contributing factors that led to this level of surplus include:

- Surplus within the RCMP contract budget due to member vacancies,
- Record high levels of staff vacancies throughout the organization,
- And higher than expected permit revenues as construction activity continued to be high with permit values exceeding \$1B.

These surpluses were offset by financial challenges such as:

- High inflation, price escalations, and supply chain challenges causing additional costs throughout the organization for items such as fuel and maintenance costs,
- Higher than expected costs for snow and ice control as heavy snow accumulations were experienced in January and again in November,
- And unexpected legal expenses.

The Airport ended the year with a \$24.8M surplus due to increasing revenues as the Airport continued to recover from the COVID-19 pandemic, combined with efforts to move strategic initiatives forward while keeping costs low. All surplus funds have been contributed to reserve to be used to fund future capital projects identified as part of the Airport long-term capital plan.

The Wastewater Utility ended the year with a \$2.5M surplus. This surplus is primarily due to additional revenues from new residential units. The surplus will be contributed to the accumulated surplus to act as an equalization fund to ensure utility rate increases are kept at acceptable levels.

The Water Utility's annual surplus is \$621k. The utility experienced several staff vacancies over the year resulting in salary and wages budgets not being used. This was offset by lower-than-expected water sales as less water was consumed throughout the community.

Further details on these surpluses can be found in the following section "Appendix A" titled "2022 Revenue - Expenditure Analysis".

2022 Reserves

The City maintains reserves to achieve policy objectives such as:

- To acquire, replace and renew major capital assets
- To ensure stable, predictable tax and utility levies
- To minimize the financial impact of unusual and unexpected events
- To achieve long-term financial stability
- To fund asset retirement obligations

The City continues to maintain a healthy reserve balance. Available reserves increased by \$31.6M between 2021 and 2022. The largest increase was in the Airport reserves (\$11.2M), mainly due to the contribution of airport improvement fee revenue being contributed to reserve. Other significant net contributions to reserve include \$5.2M in the Legacy Reserves from reinvestment of Fortis share dividends, \$5.6M from Landfill operations and \$4.5M from Parking Services.

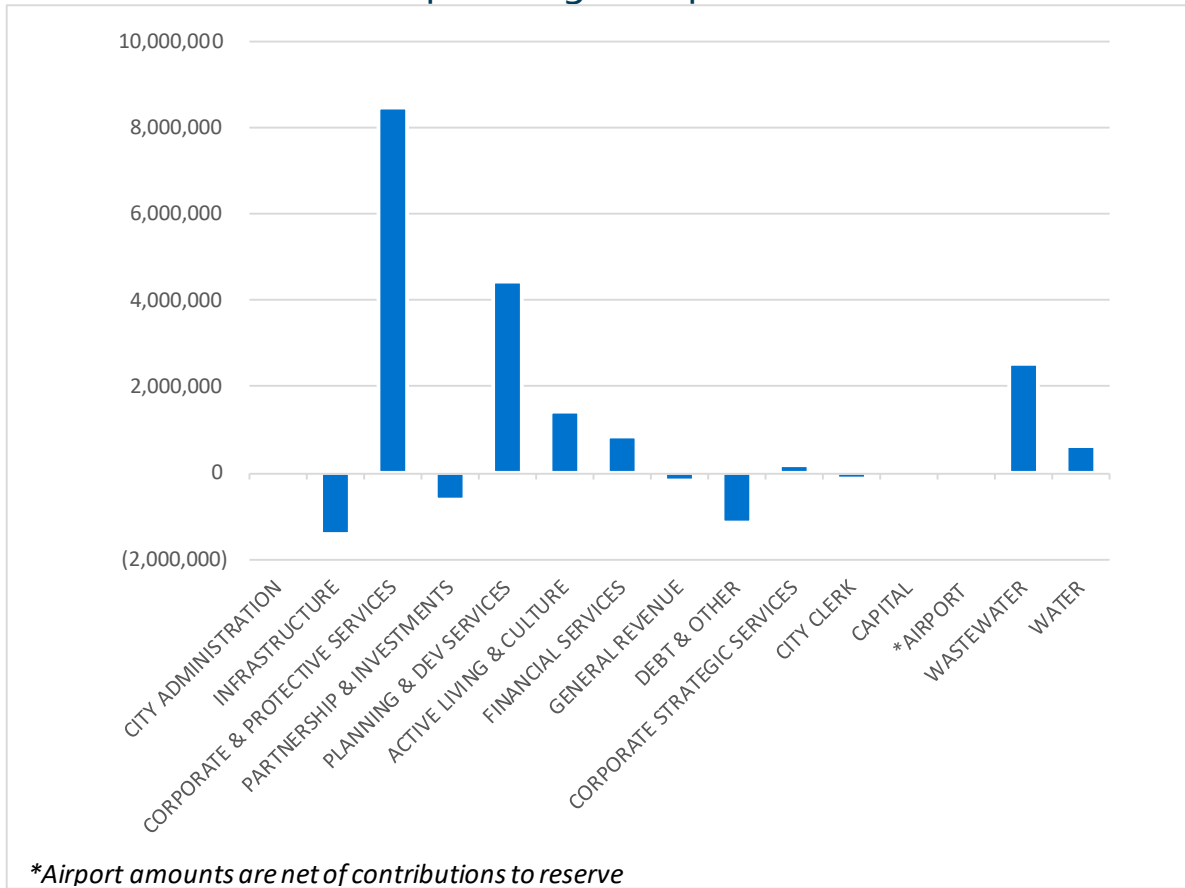
Development Cost Charges (DCC) are reported separately from other reserves as they are revenues received for specific purposes and cannot be used for any other expenditures. The DCC balance increased by \$23.6M between 2021 and 2022.

J. Sass, CPA, CA

cc: City Manager
Grant Thornton – Tyler Neels

APPENDIX A - 2022 Revenue - Expenditure Analysis

2022 Operating & Capital Results



	Actuals	Budget	Variance	
City Administration	1,917,197	1,931,848	14,651	99.2%
Infrastructure	38,792,517	37,393,222	(1,399,295)	103.7%
Corporate & Protective Services	71,557,249	80,020,397	8,463,148	89.4%
Partnerships & Investments	9,882,895	9,282,838	(600,057)	106.5%
Planning & Development Services	(4,717,597)	(286,625)	4,430,972	1645.9%
Active Living & Culture	9,637,467	11,080,189	1,442,722	87.0%
Financial Services	5,775,271	6,613,883	838,612	87.3%
General Revenues	(179,152,456)	(179,316,814)	(164,358)	99.9%
Debt & Other	9,603,587	8,476,504	(1,127,083)	113.3%
Corporate Strategic Services	9,174,096	9,369,354	195,258	97.9%
City Clerk	1,643,237	1,511,304	(131,933)	108.7%
Capital Projects (General)	13,924,569	13,923,900	(669)	100.0%
Total General Fund Deficit/(Surplus)	(11,961,967)	-	11,961,967	
Airport	-	-	-	0.0%
Wastewater Utility	(2,536,147)	-	2,536,147	0.0%
Water Utility	(621,318)	-	621,318	0.0%
Total Deficit/(Surplus)	(15,119,432)	-	15,119,432	

1. Summary of General Fund

City Administration

The City Administration Division ended the year at 99.2% of budget and a surplus of \$15k. This surplus is mostly due to unspent contingency budgets.

Infrastructure

The General Fund portion of the Infrastructure Division ended the year at 103.7% of budget and a deficit of \$1.4M. This deficit is mostly due to unexpected costs incurred for snow and ice control as the City saw heavy snow accumulations in January and again in November as part of the early winter season experienced in 2022. The Transit Branch had better than expected revenues as the city continues to financially recover from the COVID-19 pandemic but ended the year with a deficit as high inflation significantly impacted fuel and maintenance costs.

Corporate & Protective Services

The Corporate and Protective Services Division ended the year at 89.4% of budget and a surplus of \$8.5M. The majority of this surplus is related to the RCMP contract and member vacancies as well as staff vacancies throughout the division. Higher than expected casino gaming revenue and lower prisoner supervision costs also contributed to this surplus. These were partially offset with lower-than-expected penalty and fine revenue, additional costs associated with record high recruitment and hiring for the organization, and timing of insurance claims.

Partnerships & Investments

The Partnerships and Investments Division ended the year at 106.5% of budget and a deficit of \$600k. This was mostly due to inflationary pressures and price escalations of professional services, materials, and supplies for maintaining civic buildings. In addition, increased utilization of City facilities in 2022, as result of the loosening of COVID-19 related health orders, led to increased utility costs.

Planning & Development Services

The Planning and Development Division ended the year at 1645.9% of budget and a surplus of \$4.4M. Both 2021 and 2022 were unprecedented years for construction activity with permit values exceeding \$1B, resulting in larger than expected permit revenue. In addition, business license revenue was larger than expected as the growth and development of the city resulted in an increase in businesses license applications for the year. The department was also able to better manage the tracking of licensing and renewals ensuring past licenses were renewed.

Active Living & Culture

The Active Living and Culture Division ended the year at 87.0% of budget and a surplus of \$1.4M. Several budgets were not used in 2022 due to staff vacancies and community events not held due to a lack of time available for planning after the COVID-19 restrictions were lifted in quarter one. COVID-19 Safe Restart Grant funds being held in reserve were used to offset COVID-19 related revenue losses and additional costs. Other departments like the Community Theatre and Sports & Event Services saw higher than expected revenues due to a strong post-COVID recovery.

Financial Services

The Financial Services Division ended the year at 87.3% of budget and a surplus of \$839k. The surplus is mainly due to staff vacancies experienced by various branches within the division.

General Revenues

General Revenues ended the year at 99.9% of budget and a deficit of \$164k. General revenues saw better-than-expected revenues from penalties and interest on property taxes and utility bills resulting from historic increases in interest rates. Due to the surpluses in these revenues, it was decided not to sell any Fortis shares during the year resulting in a small deficit.

Debt & Other

Debt and other ended the year at 113.3% of budget and a deficit of \$1.1M. The surplus is mainly due to the salary vacancy factor that is in place to offset vacancies throughout the organization and help prevent the overtaxing of property owners. This was partially offset by the contingency for unpredictable events budget that was not used in 2022.

Corporate Strategic Services

The Corporate Strategic Services Division ended the year at 97.9% of budget and a surplus of \$195k. This surplus is mainly due to lower than anticipated costs related to Unit 4 Support and Cyber Security Enhancements projects.

City Clerk

The City Clerks Division ended the year at 108.7% of budget and a deficit of \$132k. This deficit is mainly due to unexpected legal expenses during the year.

Capital Projects (General Fund)

Capital projects ended the year at 100.0% of budget after contributions to reserve for carryover projects.

2. Summary of Airport/Utility Funds

Airport Fund

The Airport's 2022 surplus before contributions to reserve was \$24.8M. The COVID-19 pandemic had a substantial, negative impact on YLW's business beginning in March 2020, with impacts expected to continue beyond 2022. During 2022, passenger numbers increased 107% when compared to 2021 and were 1% less than what was budgeted at 1.7M. Airport revenues totaled \$51.2M for the year. This additional \$10.5M was mainly due to increased grant revenue and capital contributions. Airport operating expenditures, excluding amortization, was \$1.8M less than budget at \$18.2M. Expenditures came in under budget due to the continued, concerted effort to move strategic initiatives forward while keeping costs low to help mitigate the negative impacts of the COVID-19 pandemic.

The accumulated surplus for the Airport is \$2.4M. Accumulated surplus acts as a fund for emergencies, such as fires and floods.

Wastewater Utility Fund

The Wastewater Utility 2022 surplus was \$2.5M. The Wastewater Utility received greater than expected revenue primarily due to the higher than planned number of residential units added. This was offset by

increased costs of chemicals used for wastewater treatment and high cost of repair parts due to inflationary and supply chain challenges.

The accumulated surplus balance, before any 2022 surplus contributions, for the Wastewater Utility is \$46.6M. This includes a \$4.9M reduction over 2021 as funds were used to purchase land to be used as a strategic municipal land holding for a future Wastewater Treatment Facility and the associated buffer lands adjacent to the future facility. A portion of the accumulated surplus will be required to carry the utility through a period of higher capital infrastructure replacement over the next several years, including new mains, lift stations and facility renewal. The accumulated surplus acts as an equalization fund to ensure utility rate increases are kept at acceptable levels and as backing for debt repayment under the DCC Wastewater program.

Water Utility Fund

The Water Utility 2022 surplus was \$621k. The water utility received greater than expected revenues from investment interest due to historic increases in interest rates. This was offset by lower-than-expected water sales due to reduced water consumption throughout the community. Salary and wages expenses were less than anticipated as the utility experienced several staff vacancies. Further expense surplus was realized as there were no major operating events that occurred during the year. These surpluses were reduced by an overage in the Water Meter Replacement Stage 2 capital project as additional materials were purchased to prevent supply chain issues and project delays for the project continuation in 2023.

The accumulated surplus balance, before any 2022 surplus contributions, for the Water Utility is \$11.7M. This includes a \$2.3M increase over 2021 due to the Southeast Kelowna Local Area Service first year annual & one-time cash commutation payments received to pay back the internal financing for the water integration project. A portion of the accumulated surplus will be required to support capital renewal primarily for new water meters over the next five years. In addition to using a portion of the accumulated surplus for capital renewal, rate increases of 6% or more will be required in order to ensure the Utility does not move into a deficit position.

3. Summary of Reserve Funds

The City of Kelowna’s 2022 year-end reserve position on a comparative basis to 2021 is as follows in 000’s of dollars:

	<u>2022</u>	<u>2021</u>
General Reserves for Future Expenditures	\$129,706	\$130,833
Legacy Reserves	110,543	105,324
Statutory Reserves for Future Expenditures	125,964	116,022
Utility Reserves for Future Expenditures	91,677	73,821
Total Reserves	<u>\$457,890</u>	<u>\$426,000</u>
Less Multi-Purpose Commitment	7,283	7,014
Available Reserves	<u>\$450,607</u>	<u>\$418,986</u>

The Legacy Reserves increased by \$5.2M primarily due to reinvestment of Fortis share dividends.

4. Reserves for Future Expenditures - Increase of \$26.7M

General Fund

The General Fund has a reserve for future expenditure balance of \$129.7M of which \$19.3M represents unspent budget funds which are earmarked to be used to fund projects that are anticipated to be completed over the next few years. The total reserve for future expenditure balance decreased \$1.1M from 2021 as funds were used to help offset deficits caused by continued COVID-19 pandemic impacts.

Airport Reserves

The Airport reserves for future expenditure balance is \$45.6M, which is made up by the following reserve balances: \$20.1M Airport Improvement Fee, \$(0.8M) Airport Terminal, \$26.1M Airport Groundside, \$Nil Airport Airside, and \$0.2M Airport Fringe Benefit. There was an overall fund increase of \$11.2M due to revenues exceeding the acquisition of tangible capital assets. The reserve fund balances are committed for future capital projects identified as part of the airport long-term capital plan.

Wastewater Utility

The Wastewater Utility has a reserve for future expenditure balance of \$18.7M of which \$14.9M represents unspent budget funds which are earmarked for future use. The total reserve for future expenditure balance increased \$2.5M from 2021 due to carryover projects. These projects are anticipated to be completed in future years as some are completed over several years.

Water Utility

The Water Utility has a reserve for future expenditure balance of \$27.4M. This is an increase of \$4.5M which can be attributed to an overall increase in carried over unspent budget funds of \$751k, and an increase to the Water Quality Enhancement of \$3.5M.

Statutory Reserves

The Statutory reserves have a future expenditure balance of \$126.0M. This is an increase of \$9.9M which is primarily attributed to Parking and Landfill profits being contributed to reserve for future capital requirements.

5. Deferred Development Cost Charges

The Development Cost Charge balance has increased by \$23.6M. Development Cost Charge revenues totaled \$40.3M while expenditures were \$16.8M. The consolidated closing deferred DCC balance was \$148.1M.