

# Policy

<b>Title: FINANCIAL RESERVES POLICY</b>		<b>Number: 0168</b>
<b>Reference:</b> Administrative Committee - August 14, 2024  Corporate Services Committee - August 22, 2024	<b>Adopted by City Council:</b> October 7, 2024	<b>Supersedes:</b>  January 1, 2021
	City Clerk	
<b>Prepared by:</b> CORPORATE SERVICES DIVISION, FINANCE DEPARTMENT		

## STATEMENT

**THE PURPOSE OF THIS POLICY IS TO ESTABLISH CONSISTENT STANDARDS AND GUIDELINES FOR THE ADMINISTRATION OF FINANCIAL RESERVES.**

**THE ESTABLISHMENT OF A FINANCIAL RESERVES POLICY IS A PRUDENT BUSINESS PRACTICE, WHICH ENHANCES THE CITY'S FINANCIAL STRENGTH, FLEXIBILITY, CASH FLOW MANAGEMENT AND THE ABILITY TO ACHIEVE CITY COUNCIL'S VISION AND STRATEGIC PRIORITIES.**

**THIS POLICY WILL PROMOTE STRONG FINANCIAL LEADERSHIP AND PLANNING TO ENSURE THE LONG-TERM VIABILITY OF THE CORPORATION.**

## PRINCIPLES

1. **Adherence to Statutory Requirements:** This Policy shall be governed by the Municipal Government Act and related City Bylaws.
2. **Sustainability:** Financial Reserves shall be managed to maintain and improve the City's working capital requirements within targeted debt limits.
3. **Stabilization:** Provide stabilization for fluctuations in operating and capital activities and mitigate the risk of revenue or expenditure volatility.
4. **Long-Term Planning:** Provide equity for future growth capital funding requirements, support asset management planning, plan for contingencies, establish long-term endowment savings and generate investment income.

## ROLE OF COUNCIL

1. To receive, review and adopt this policy and any recommended amendments thereto.

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## 1. DEFINITIONS

- 1.01 Abandonment Obligations Reserve Fund – a financial reserve fund established to maintain adequate funds over time and support funding for the City's asset retirement obligations.
- 1.02 Alberta Consumer Price Index or Alberta CPI - means the Alberta All-Items Consumer Price Index published by Statistics Canada as an inflation measure that tracks the changes in Alberta consumer prices experienced over time for a fixed basket of goods and services purchased by the consumer.
- 1.03 Asset Retirement Obligation (ARO) – a legal obligation associated with the retirement of a tangible capital asset.
- 1.04 Business Units - includes the operations of Tax Supported, Rate-Based Utilities, Energy Production and Land Development & Real Estate.
- 1.05 Capital Reserve Fund - a financial reserve fund established to maintain adequate capital to fund the City's Capital requirements.
- 1.06 Debt-to-Equity Ratio - the ratio of an entity's consolidated debt to its consolidated equity. For the City of Medicine Hat, the Debt-to-Equity ratio is calculated by consolidating all the City's debts and dividing that by the total value of all its equity.
- 1.07 Energy Transition Reserve Fund – a financial reserve fund established to support the transition of the City's energy infrastructure to achieve a net zero emissions target as prescribed by the provincial and federal government.
- 1.08 Free Cash Flow (FCF) - the cash generated after taking into consideration cash outflows that support operations and maintains capital assets.
- 1.09 Growth Capital - capital expenditures required to expand the service or productive capacity of a given Business Unit.
- 1.10 Medicine Hat Endowment Fund (formerly the Heritage Savings Reserve) - a long-term endowment fund for the benefit of the citizens of the City of Medicine Hat.
- 1.11 Operating Reserve Fund - a financial reserve fund established to fund the City's Working Capital and provide adequate liquidity for daily operations of the City's Business Units.
- 1.12 Financial Reserve - a fund used to account for the proceeds of specific revenue sources to meet specific future expenditure requirements.
- 1.13 Unfunded Liabilities - liabilities for which the City has financial responsibility but for which no funding has been identified or formally set aside.
- 1.14 Working Capital - defined as current assets minus current liabilities. Working Capital is necessary for an entity to have sufficient liquidity to perform daily business.

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## 2. RESPONSIBILITIES

### 2.01 Administrative Committee

- (a) Review and recommend changes to this policy.
- (b) Review and approve the procedures related to this policy.

### 2.02 City Manager

- (a) Request City Council approval for the establishment of a new Financial Reserve.
- (b) Seek approval for all allocations from a Financial Reserve as outlined in the Reserve Description Details (Section 4).
- (c) Notify City Council of any market impacts that may adversely affect the asset value of the Financial Reserves.
- (d) Provide regular updates to Council throughout the year of the status of the Financial Reserves relative to expected funding requirements.
- (e) Provides regular updates to Council throughout the year of the status of the City's debt ratios relative to the limits, which have been established.
- (f) Approve the allocation of Free Cash Flow to Municipal Operations, Capital Reserve, Operating Reserve, Medicine Hat Endowment Fund, Abandonment Obligations Reserve, and Energy Transition Reserve.

### 2.03 Business Unit Managing Directors and Directors

- (a) Review Business Unit financial information, sensitivity analysis and reserve levels from Finance Department to manage current and future levels of service.
- (b) Provide relevant information on market impacts that may affect the asset value or profitability of the Business Unit and requirements to access reserves.
- (c) Review Business Unit Debt-to-Equity levels to ensure they comply with limits and targets established for the department and for the City overall.

### 2.04 Managing Director, Corporate Services/CFO

- (a) Recommend the calculation, allocation, and transfer of Free Cash Flow amounts from Business Units to Municipal Operations, Capital Reserve Fund, Operating Reserve Fund, Medicine Hat Endowment Fund, Abandonment Obligations Reserve, Energy Transition Reserve as applicable.

### 2.05 Finance Department

- (a) Maintain a 10-year forecast of Free Cash Flow for each Business Unit and consolidated for the City.
- (b) At the end of each fiscal year, calculate the Free Cash Flow amounts from Business Units.
- (c) Provide sensitivity analysis on pro-forma income and cash flows for the Business Units and their Financial Reserve requirements for future Capital.
- (d) Manage the Capital Reserve Fund, Operating Reserve Fund, Medicine Hat Endowment Fund, Abandonment Obligations Reserve Fund, and Energy Transition Reserve Fund to ensure proper targets and limits are maintained.
- (e) At the end of each fiscal year, distribute the Free Cash Flow amounts from Business Units to the City Financial Reserves in a tiered priority basis: Municipal Operations, Capital Reserve Fund, Operating Reserve Fund, Abandonment Obligations Reserve Fund and Energy Transition Reserve Fund.

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- (f) Inform the Managing Director, Corporate Services and City Manager of the allocation of Free Cash Flow to the Financial Reserves and Municipal Operations.
- (g) Maintain a 10-year Reserve Requirements Report for each Financial Reserve including:
  - create and maintain adequate reserve subcategories for each Financial Reserve as appropriate,
  - develop and maintain a target reserve requirement balance and related funding requirements by year,
  - schedule of future Capital by year for each Business Unit,
  - determine the funds required for the equity portion of future Capital for each Business Unit,
  - ensure appropriate Debt-to-Equity levels are determined and maintained for the Business Units and the City overall,
  - provide analysis on the sustainability of the Financial Reserves.
- (h) Annually, determine and distribute Financial Reserve funds to Business Units based on funding requirements.

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### 3. PROCEDURES

- (a) All Financial Reserves will be administered in accordance with current municipal policies, Public Sector Accounting Standards, the Municipal Government Act (MGA) or other legal requirements and as directed by the City Manager and City Council.
- (b) All allocations from a Financial Reserve will be authorized as outlined in the Reserve Description Details (Section 4).
- (c) The establishment of a new Financial Reserve must be approved by City Council and will require a new reserve description detail.
- (d) Financial Reserves will be funded from internal or external sources as approved by City Council and defined in the Reserve Description Details (Section 4).
- (e) Interest earnings will be applied to the reserves, where deemed as interest bearing as indicated in the Reserve Description Details (Section 4).
- (f) The operating and capital budget should include Financial Reserve activity where applicable.
- (g) Strategies to maintain the optimal/target balance in each Financial Reserve will be addressed through business plan and budget process.
- (h) Reporting:
  - i. Documentation of reserve activity will be accurate, completed and maintained.
  - ii. Periodic reporting on the Financial Reserves to the Audit Committee will occur through the Financial Reserve Analysis in the Operating Forecast and the Unaudited Report. This report will include the opening balance, reserve transactions, the ending balance and any future committed funds, as well as the Reserve Requirements Report.
  - iii. The City of Medicine Hat Consolidated Financial Statements includes a note on Reserve Balances. Financial Reserves (along with accumulated surplus, equity in tangible capital assets and unrestricted balances) are included within the Municipal Equity section of the Consolidated Statement of Financial Position.

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#### 4. RESERVE DESCRIPTION DETAILS

<b>OPERATING RESERVE FUND</b>	
Account Number:	xxxx
Year Established:	2020
Purpose:	To stabilize fluctuations in operating activity and to address the risk of revenue or expenditure volatility.
Source of Funding:	Free Cash Flow as per Distributable Funds/Dividend Policy No. 0169 and other sources as approved by Council. Any excess surplus from municipal operations may be transferred to the operating reserve as required.
Type of Expenditure:	Operating
Target Balance	Minimum level - 10% of annual municipal expenditures (excluding non-cash items). Target/Optimum level - 30% of annual municipal expenditures (excluding non-cash items).
Authorization Required for Use:	Administrative Committee approves transfers from the operating reserves to maintain the operations and affairs of the City. All other transfers are through budget approval or authorization by City Council.
Interest Bearing:	No
Significant changes made to the reserve and approved by Council:	
Notes/Comments:	The Operating Reserve Fund includes specific Financial Reserve subcategories such as, but not limited to: Tax Rate Stabilization, Insurance, Investment, Weather, Employee Development.

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<b>CAPITAL RESERVE FUND</b>	
Account Number:	xxxx
Year Established:	2020
Purpose:	To support the funding of the City's Capital requirements
Source of Funding:	Free Cash Flow as per Distributable Funds/Dividend Policy No. 0169 and other sources as approved by Council.
Type of Expenditure:	Capital
Target Balance	N/A
Authorization Required for Use:	Budget approval or authorization by City Council.
Interest Bearing:	No
Significant changes made to the reserve and approved by Council:	
Notes/Comments:	The Capital Reserve Fund includes specific Financial Reserve subcategories for each Business Unit.

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<b>MEDICINE HAT ENDOWMENT FUND</b>	
Account Number:	xxxx
Year Established:	2020
Purpose:	To create an endowment fund for the benefit of the people of Medicine Hat. This benefit will be provided through the following three general streams: Financial Sustainability, Economic Evolution, and Community Liveability in alignment with the strategic plan of Council.
Source of Funding:	Free Cash Flow as per Distributable Funds/Dividend Policy No. 0169, investment income, and other sources as approved by Council.
Type of Expenditure:	Capital and Operating
Target Balance:	\$200 million. Adjusted and protected for inflation using the Alberta Consumer Price Index.
Authorization Required for Use:	In accordance with Bylaw #4827; Budget approval or authorization by City Council.
Interest Bearing:	Yes, funds will be invested as per Investment Policy #0167. A proportionate share of the investment management fees will be charged to the reserve.
Significant changes made to the reserve and approved by Council:	
Notes/Comments:	See Medicine Hat Endowment Fund Bylaw #4827 for specific use of reserve.



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<b>ABANDONMENT OBLIGATIONS RESERVE FUND</b>	
Account Number:	xxxx
Year Established:	2024
Purpose:	To support the funding of the City's asset retirement obligations
Source of Funding:	Initial one-time transfer of \$75M from unrestricted surplus; Free Cash Flow as per Distributable Funds/Dividend Policy No. 0169, and other sources as approved by Council.
Type of Expenditure:	Operating and capital expenditures to support funding of abandonment obligations.
Target Balance:	N/A
Authorization Required for Use:	Budget approval and authorization by City Council.
Interest Bearing:	Yes, funds will be invested as per Investment Policy #0167. A proportionate share of the investment management fees will be charged to the reserve.
Significant changes made to the reserve and approved by Council:	
Notes/Comments:	

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<b>ENERGY TRANSITION RESERVE FUND</b>	
Account Number:	xxxx
Year Established:	2024
Purpose:	To support the funding of the transition of the City's energy infrastructure to achieve a net zero emissions target as prescribed by the provincial and federal government.
Source of Funding:	Initial one-time transfer of \$75M from unrestricted surplus; Free Cash Flow as per Distributable Funds/Dividend Policy No. 0169, and other sources as approved by Council
Type of Expenditure:	Operating and capital expenditures.
Target Balance:	N/A
Authorization Required for Use:	Budget approval and authorization by City Council.
Interest Bearing:	Yes, funds will be invested as per Investment Policy #0167. A proportionate share of the investment management fees will be charged to the reserve.
Significant changes made to the reserve and approved by Council:	
Notes/Comments:	

## 5. APPENDICES

None