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General/Finance Committee
Township of Muskoka Lakes
1 Bailey Street,
Port Carling, ON
POB 1J0

December 10th, 2021

Dear Chair Zavitz and Committee Members,

Re: 2022 Draft Operating and Capital Budget and Forecast

The Muskoka Lakes Association (“MLA”) welcomes the opportunity to make a follow-up submission to the General/Finance Committee on the proposed budget for 2022. We have had the opportunity to discuss our concerns raised in our letter to Council dated November 30th, 2021 with Staff and believe this matter warrants further attention.

During discussions on the budget, we often heard comments along the lines of:

“We need to build reserves to fund the planned \$77 million in capital expenses.”

“The Township may have to take on debt to fund capital expenses, but would rather not.”

“We must raise taxes to fund reserves.”

If these statements sound reasonable, then there is a misunderstanding of just what capital reserves represent. This misunderstanding has resulted in the Township collecting taxes far in excess of its needs. **At current tax levels, the Township could forego collecting its portion of property taxes this year and still meet all its funding requirements.** Even more surprising, the Township could forego collecting taxes once every five years going forward and still fully fund its capital and operating budget as presented.

Reserve Balances

In the context of municipal budgeting, capital reserves have a specific meaning and use, which has led to confusion and resulted in over taxation the past five years. Capital reserves are the financial equivalent of working capital required for operating expenses. A more tangible example is a chequing account where a relatively small balance is kept to ensure monthly automatic withdrawals go through and not have to worry if the exact amount for each bill is in the account. Reserves are not a long term savings account. These amounts are required to account for year to year timing differences in contributions to reserves and capital expenses taken from reserves. **Ideally, capital reserves should be zero every year.** This is an important point to appreciate. However, we don’t live in an ideal world and striving for perfect capital expense timing is not desirable as it leads to other inefficiencies.

From the Township’s inception to 2015, capital reserve needs have been less than \$3 mm and actual reserves have been maintained around this level or lower.

The figure below is the 2022 Reserve Balance Ten Year Forecast [1], which provides great insight into planning behind the overall budget. The ten year budget appears to be well constructed with increases in contributions to reserves (point ‘A’) on average held to 1.4% annually, in line with future inflation expectations. The timing of capital expenditures, which the township has some control over, appears to be well thought out with a maximum year-to-year change in reserves of just \$1.8 mm occurring from 2022 to 2023 (point ‘B’). **Based on the presented budget forecast, the township’s actual reserve requirement is less than \$2 mm.** Most importantly, the ten year capital budget is fully funded as evidenced by the reserve balance being flat 2023 to 2031 (points ‘C’), with \$1.8 mm in spending above reserve contributions for just 2022. The Township has also indicated that it does not expect any anomalous expenditures in years beyond its current ten year forecast.

This raises the question of why is the Township continuing to build these reserves with no need for this money collected from taxpayers.

Reserve Balance Forecast Budget Year: 2022

Summary

Description	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Opening Balance	15,474,267	13,972,028	12,105,418	12,413,943	11,561,861	13,001,000	12,419,117	13,864,411	12,580,374	13,188,345
Capital Fund Requirements	(8,210,483)	(8,552,012)	(6,881,908)	(8,233,862)	(5,855,596)	(8,125,401)	(6,286,585)	(9,044,823)	(6,996,480)	(8,881,892)
Fund Contributions A	6,553,500	6,545,400	6,944,000	7,133,503	7,063,500	7,283,500	7,483,500	7,483,500	7,353,500	7,483,500
Interest Earned	154,744	140,002	246,433	248,277	231,235	260,018	248,379	277,286	250,951	264,081
Closing Balance	13,972,028	12,105,418	12,413,943	11,561,861	13,001,000	12,419,117	13,864,411	12,580,374	13,188,345	12,054,034

B

C

Restricted Reserves

There is also some confusion as to what is restricted reserves. The Township receives funding from non-tax levy sources that have restrictions on what those monies can be spent on, hence the term restricted. Based on the audited 2020 financial results [2], there is \$1.97 mm in restricted cash from development charges and \$1.58 mm in restricted cash from contributions in lieu of setting aside parklands, for a total of \$3.55 mm in restricted cash. There is apparently something on the order of \$3 mm that has been collected from construction permits that while having restrictions on its uses, is not identified as being restricted in the audited financial statements and is included in the overall reserve budget of the Township. Similarly, there are other sources of non-tax levy funding from transfers from other levels of government that come with restrictions on their use, but also appear in the capital budget. **It is important to note that these restrictions just impact which capital projects are allocated to these revenue sources and otherwise are intended to contribute to the normal operations of the Township.**

In total, as of December 31, 2020, the township had \$22.9 mm in cash [3] of which around \$6.6 mm [4] was obtained from non-tax levy sources and has restriction surrounding its uses. We note those expenditures are included in the overall capital spending and reserve budget.

The MLA recommends that capital and operating spending tied to non-tax levy sources be presented separately as there are different drivers behind the sources and uses of funds than encountered in tax levy driven decisions.

Tax Increases

Recent tax increases have centered around the mistaken belief that the Township needs to build reserves to fund future capital spending. This is incorrect as the Township's spending plans for the foreseeable future are properly fully funded from tax-levy and other fund contributions as described above. The Township has a total of \$22.9 mm in cash as of December 2020 [2], of which approximately \$6.6 mm [4] is restricted or tied to specific future capital expenditures. The net cash balance of \$16 mm less actual reserve requirements of \$2 mm, as detailed above, equates to \$14 mm in excess cash and leads the MLA to conclude that property owners have been overtaxed by a full year's worth of property taxes or \$13 mm [5] accumulated the past five years, and this excess collected taxes is expected to double in less than 5 years' time.

The MLA appreciates that the concerns presented here cannot be fully addressed in the current budget period. The MLA would request that the tax rate not be increased this year. The increase in total assessment from new construction will result in an increase of revenues to the Township of 1.7%, which is well in excess of 0.65% inflation [6] without further increasing the tax burden. For the 2023 budget, the MLA would request zero-based budgeting be adopted with all spending decisions driven by service needs and the cost of providing those services. This would also provide the Township a full year to properly assess its capital reserve requirements going forward and plan future taxation levels to correct the current situation. This exercise will be especially well timed given MPAC plans to reassess all property values in 2022 for the first time since 2016.

Thank you for this opportunity to provide our comments on the 2022 draft Township budget.

Sincerely,



Susan Eplett
VP and Chair, Government & Land Use Committee



Dayle Hogg
Budget Chair

cc: Mark Donaldson, Director of Financial Services
Derrick Hammond, Chief Administrative Office

- 1 – 2022 TML Draft Operating and Capital Budget dated 2021-11-03 page 115.
- 2 – Consolidated Statement of Financial Position, page 4 and note 1 on page 12.
- 3 – \$19.24 mm in cash plus \$3.64 mm in restricted cash for \$22.9 mm in total cash.
- 4 – \$1.97 mm development charges plus \$1.58 mm contributions in lieu of setting aside parklands plus \$3 mm construction permits equals \$6.6 mm in total reserves tied to specific uses.
- 5 – 2022 TML Draft Operating and Capital Budget dated 2021-11-03 page 3.
- 6 – Ontario all-items 2020 CPI: 0.65%
<https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1810000501&pickMembers%5B0%5D=1.14&cubeTimeFrame.startYear=2016&cubeTimeFrame.endYear=2020&referencePeriods=20160101%2C20200101>