

## 2019-2022 Operating Budget Outlook

### Recommendation

That the June 26, 2018, Financial and Corporate Services report CR\_5669, be received for information.

### Executive Summary

The 2019-2022 Operating Budget Outlook is a preliminary view and discussion of the forecast and pressures for the next four year operating budget. This is the first step in the development and presentation of the proposed 2019-2022 Operating Budget that will be released in the fall of 2018.

To assist with preparing Council for the budget deliberations, this Operating Budget Outlook includes:

- The forecasted economic environment for the next four years;
- The pressures being managed with the current budget and how these may impact the next four years;
- The revenue and expenditure outlooks;
- The principles Administration will use to draft the proposed budget; and
- The approach Administration is using to develop the four year budget.

### Report

Administration has developed the Operating Budget Outlook to provide Council with a view of the environment and pressures that currently exist while the four year operating budget is being developed. Using the economic forecast for 2019-2022 and anticipated increases in inflation and growth as guidelines, Administration is analyzing budget pressures to manage tax increases over the next four year operating budget cycle.

Over and above any pressures associated with providing existing services, a number of dedicated tax increases are required over the next four years:

- Valley Line LRT - Construction and operation of the Valley Line LRT requires tax rate increases of 0.6% in each of 2019 and 2020, and 0.3% in each of 2021 and 2022.
- Alley Renewal Program - Tax increases of approximately 0.3% for 2019 through 2022 are anticipated for the alley renewal program.

- The Police Funding Formula could potentially add an additional 1.0% tax increase in each of the four years of the operating budget.

Identifying, evaluating and analyzing the economic environment and budget pressures is the first step in developing and delivering the proposed 2019-2022 Operating Budget to Council in November of 2018. As such, Administration will incorporate any feedback Council may have and continue to develop the proposed budget over the coming months while working to manage cost pressures and limiting any impact on existing service levels. The City of Edmonton is committed to the continuous improvement of service delivery. The development of the 2019-2022 Operating Budget will incorporate ongoing savings identified through greater efficiencies, process improvement, technological innovation, and the Program and Service review.

### Edmonton's Economic Outlook

Beginning in the mid 2000s, the City of Edmonton experienced a tremendous period of growth and enhanced service delivery. This included increased investment in the renewal and maintenance of the City's existing infrastructure and building new infrastructure and facilities to meet the increasing demands and pressures of a rapidly growing city. Over the past three years, as the oil and gas industry experienced another cyclical downturn, Alberta and Edmonton saw slower population growth and higher unemployment. Starting in late 2017 and early 2018, both the Alberta and Edmonton economies began slowly recovering. Today, business activity is beginning to expand and employment levels are returning to their pre-recession levels.

Given the current state of global energy markets, natural gas prices are expected to remain low indefinitely while crude oil prices are expected to remain in the low-to-medium price band for the foreseeable future, barring any major global catastrophes. Consequently, it is expected that Edmonton's population and economy will continue to grow over the 2019-2022 forecast period, albeit at a more moderate pace after having come through the economic downturn in 2015-2017. The demand for new services and infrastructure and the pressure on existing services and infrastructure will also continue to grow.

Continuing international/interprovincial migration and relatively strong natural population growth are reflected in Edmonton's young demographic profile (which will continue in the coming years). This means that Edmonton will have to deal with a growing population and service demands that are greater than in many Canadian cities, while simultaneously grappling with an economy that is stable but does not show the high growth that occurred in the past. Adding to this mix is that after an extended period of very low interest rates, rates in both Canada and the United States are beginning to rise. As a result, borrowing costs can be expected to increase in the

coming years. However, the rise in rates will be gradual as inflationary pressures remain low in Canada and globally.

A summary of key economic indicators is provided in the table below:

<b>Forecast Growth</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
Population	1.7%	1.9%	2.0%	2.1%
Economic Growth (GDP)	2.7%	2.3%	2.4%	2.5%
Consumer Price Index	1.6%	2.0%	1.9%	1.9%

## 2018 Operating Budget

Through a review of the first quarter operating results, Administration has identified a number of pressures within the 2018 budget that could have a significant impact on the City's 2018 year end financial results. These pressures include lower than budgeted franchise fee revenue, lower taxation revenue as a result of tax exemptions on social housing properties, and increasing fuel costs.

Franchise fee revenue is projected to be \$11.1 million lower than budgeted for 2018 as a result of a reduction in ATCO Gas delivery rates that became effective April 1, 2018. These reduced delivery rates are also anticipated to have an impact on the proposed 2019-2022 Operating Budget. Administration is exploring options to address the expected revenue shortfall in 2018 and is considering strategies to mitigate the impact of reduced franchise fees in future budgets.

Tax revenue collected from social housing properties is another pressure point on the Operating Budget. A \$3.5 million revenue shortfall is projected in 2018 as a result of a provincial decision to make social housing properties exempt, and therefore the taxable status for certain properties is still in question. This is a pressure that will need to be addressed in the proposed 2019-2022 Operating Budget.

Increasing fuel prices could have a negative impact on the 2018 year end financial results. An unfavourable variance of approximately \$6.0 to \$8.0 million is currently projected for 2018 if fuel prices remain at the current levels for the remainder of the year.

Current projections indicate that, compared to the 2018 operating budget, these items combined have the potential to create unfavourable variances up to \$20.6 million. These emerging financial items are the result of external factors beyond the City's control, and Administration is currently assessing the impact of these items in the development of the proposed 2019-2022 Operating Budget. During the remainder of

2018, Administration will look to manage the operating budget in order to mitigate the impact of these unfavourable budget variances on tax-supported operations and on the Financial Stabilization Reserve.

### 2019 - 2022 Revenue Outlook

Property tax is the City's most significant source of revenue. Revenue growth can be generated from property tax in two ways: 1) from tax lifts due to real assessment growth; and 2) from Council-approved tax increases. The former refers to tax revenues generated from new residential and non-residential properties that are built and added to the City's assessment base. The latter refers to tax revenues generated from Council-approved tax levy increases. Projected real assessment growth is \$27.7 million in 2019, \$28.9 million in 2020, \$33.8 million in 2021, and \$35.4 million in 2022. Like the economic outlook, the forecasted tax lifts from real assessment growth are based on a low-to-moderate growth scenario.

The second largest revenue category includes user fee, fines, permit, and licence revenues, with user fees comprising the majority of the category. User fee revenues can grow in three ways: 1) from volume increases; 2) from rate increases; and 3) from a combination of volume and rate increases. Volume increases reflect demand growth for City services that levy a user fee. Rate increases refer to increases to the price charged for these services, which are subject to Council approval. Administration will bring forward recommended user fee rate increases in the fall of 2018.

### 2019 - 2022 Expenditure Outlook

There are a number of cost pressures impacting the 2019-2022 operating budget including inflation, a growing population and demand on existing service levels, and operating costs associated with new capital projects. There are also a number of emerging issues that could potentially impact the operating budget including collaborative approaches to deal with shared services and investments in the Edmonton Metropolitan Region, the growth in City boundaries including the proposed Leduc County annexation, and the legalization of Cannabis. As part of the development of the 2019-2022 operating budget, Administration will continue to identify ongoing savings through greater efficiencies and process improvements to minimize the impact of these cost pressures.

The City provides a wide range of services that Edmontonians use every day. The majority of the City's programs and services are citizen focused and labour intensive. Each year, personnel costs are the single largest cost driver for the City. These cost increases are largely driven by collective agreements that set wages, salaries, and benefits, and to a lesser extent by in-range merit increases. Most collective agreements end in 2018, with no agreements yet in place for 2019 and beyond. As such, Administration must make assumptions on potential settlements for each budget year to prepare the budget. There are also costs associated with new personnel that

are required when new infrastructure and facilities are brought into operational service - for example, staff to operate new libraries, recreation facilities, and LRT lines.

### Budget Principles

In developing the operating budget, Administration is guided by several budget principles that have been endorsed by Council in previous years. Administration believes that the principles are still valid; however, they have been updated to reflect the current practices and approach for the multi-year budget cycle.

The principles have been included for Council's information as Attachment 1.

### Dedicated Tax Increases

Since 2016, Council has approved annual incremental dedicated tax increases to support the construction and eventual operation of the Valley Line Southeast LRT. These dedicated increases are scheduled to continue from 2019 to 2022, at which point the annual dedicated tax levy will reach its target. Annual incremental dedicated tax increases are projected to be \$9.8 million (0.6%) in 2019, \$10.3 million (0.6%) in 2020, \$5.3 million (0.3%) in 2021, and \$5.7 million (0.3%) in 2022.

Adopted in 2017, the alley renewal strategy resulted in a new program to provide predictable and stable tax support for the maintenance of alleyways. To support this program the current forecast is for a \$4.8 million incremental tax increase in 2019, a \$6.7 million increase in 2020, a \$5.4 million increase in 2021, and a \$5.3 million increase in 2022. By 2022, the program will be fully funded at \$22.3 million in annual tax levy funding.

Beginning with the 2016-2018 Operating Budget, the City provides a dedicated level of funding to Edmonton Police Service (EPS) determined by a funding formula that adjusts annual funding based on inflation and population growth. Council will review the funding formula used for the 2016-2018 budget cycle prior to deliberations for the 2019-2022 budget. Based on proposed adjustments to the formula, Administration projects an incremental annual expenditure increase of \$14.9 million in EPS funding in 2019, eventually growing to approximately \$19.1 million in 2022.

### Service Packages

Unfunded service packages will also be included in the proposed 2019-2022 Operating Budget for Council consideration. As in prior budgets, these packages will generally consist of requests for new funding to support initiatives that cannot be supported within the existing budgets. The packages being put forward are typically included because they were identified through a previous Council motion, assist in moving a Council initiative forward, or are being requested from an external board or agency.

## Public Engagement and Communications

Administration is considering various approaches to communicate the proposed 2019-2022 Operating Budget, and gather public input. The communications plan aims to improve the public's understanding of how City funds are spent and how the budget is developed.

The communications approach for the 2019-2022 budget cycle will include some activities used in prior years such as having members of Administration attend various events and festivals to provide citizens with an opportunity to learn more about the City's budgets. Administration will also be looking at using other opportunities for public outreach including updating the yegcitybudget website and using a web based survey tool for members of the public to indicate their preference on the allocation of tax dollars to various City services. Members of the public will also have instant access to all budget information through the Open Budget tool.

All public input received will be presented at the time of the Non-Statutory Public Hearing for Council to consider. Similar to other years, the Non-Statutory Public Hearing will provide Edmontonians with the opportunity to address City Council directly on concerns or questions regarding the proposed 2019-2022 Operating Budget.

The communications approach this year will also include research to establish a baseline of public and media understanding of the City's budget, and identify education and information needs. This will be used to inform, measure and enhance ongoing budget-related communications activities over the next four years.

## Corporate Outcomes and Performance Management

Corporate Outcome(s): The City of Edmonton has a resilient financial position.			
Outcome(s)	Measure(s)	Result(s)	Target(s)
The City of Edmonton has a resilient financial position.	City Asset Sustainability (Actual expenditure on capital infrastructure divided by required expenditure)	0.94 (2017)	1.00 (2018)
	City of Edmonton Credit Rating (Standard & Poor's rating)	AA+ (2017)	AA+ (2018)

## Attachment

1. Budget Principles

### **Others Reviewing this Report**

- M. Sturgeon, Acting Deputy City Manager, Communications and Engagement
- G. Cebryk, Deputy City Manager, City Operations
- R. G. Klassen, Deputy City Manager, Regional and Economic Development
- A. Laughlin, Deputy City Manager, Integrated Infrastructure Services
- L. McCarthy, Deputy City Manager, Urban Form and Corporate Strategic Development
- K. Block, Acting Deputy City Manager, Citizen Services
- R. Smyth, Acting Deputy City Manager, Employee Services