OFFICE OF
THE CITY AUDITOR

REPORT
CITY FINANCIAL CONDITION UPDATE

OCTOBER 3, 2022

OCA01511 - Attachment 1

Report Summary

BACKGROUND

In November 2020, the Office of the City Auditor reported on the City's financial health by reviewing nine types of information that are good indicators of financial health.

At that time, it was difficult to predict the financial impact of COVID-19 on the City. Revenues were undetermined due to uncertain funding from other orders of government. Expenses could not be predicted due to the potential need to significantly reduce City services and spending.

Our 2022 Annual Work Plan included an updated compilation of the indicators the Office identified in 2020. As the City is currently working on the 2023-2026 Budget, reviewing and reporting on these nine indicators may provide some insights on the City's financial health to inform this process.

PURPOSE & SCOPE[1]

This report updates the nine financial indicators first reported in November 2020 City Financial Condition Review. This report provides historical information on indicators from 2000 to 2021.

Analysis and conclusions relating to the quality or appropriateness of any policy or budget decisions made by Council or Administration are out of scope of this review.

WHAT WE FOUND

Overall, from 2019 to 2021, the City relied more on property tax and less on federal and provincial government grants. Operating spending decreased relative to inflation and population growth. Long-term debt per capita has increased, relative to operating expenses, as has the cost of servicing that debt. The value of capital assets increased every year and the condition of these assets has improved. The City's uncommitted

[1] We conducted this engagement in conformance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

reserves relative to operating spending and financial assets to liabilities ratio have both remained fairly consistent.

For 2020 and 2021, the City managed the financial impacts of COVID through expense management strategies and use of funding from external governments. Ongoing revenue impacts to user fees and other revenue sources will be addressed through the 2023-2026 budget. Below are the specific indicators with comparatives over the last three years.

Indicator	**2019**	**2020**	**2021**
Property tax as a percentage of total revenue	43.2%	44.4%	44.9%
Government grants/transfers as a percentage of total revenue	17.9%	21.7%	14.4%
Operating spending growth since 2000, in excess of population growth and inflation	34.6%	23.5%	21.6%
Change in value of capital assets	5.8%	6.7%	4.2%
Capital asset condition: % poor/very poor % fair % good/very good	 11.0% 39.5% 49.5%	 8.6% 35.7% 55.7%	 9.1% 38.7% 52.2%
Long-term debt per capita	$3,353	$3,249	$3,118
Debt service payments as a percentage of operating spending	11.8%	13.0%	13.7%
Uncommitted financial reserves as a percentage of operating spending	4.9%	5.4%	4.9%
Financial assets to liabilities ratio	1.52	1.50	1.51

WHY THIS IS IMPORTANT

Understanding the financial sustainability and viability of the corporation helps inform fiscally-responsible decision making.

Updated Indicators

WHAT IS FINANCIAL CONDITION?

Financial condition indicators show how healthy a city's finances are at a point in time. When a City is financially healthy, it is able to deliver the services that its residents expect with the resources they provide, both in the present and in the future. It can sustain current service levels, endure economic challenges, and respond to change.

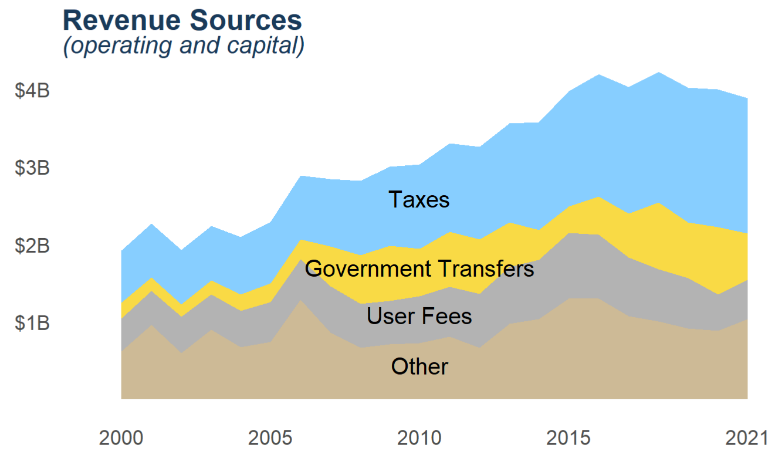
This report provides an update to nine indicators of the City's financial condition. These nine indicators represent the City's revenue, operating spending, capital spending, debt, and financial position.

	Indicator
Revenue	Property tax reliance
	Government grant/transfer reliance
Operating Spending	Operating spending growth relative to inflation and population growth
Capital Spending	Change in value of capital assets
	Capital asset condition
Debt	Debt per capita
	Debt service relative to total operating spending
Financial Position	Uncommitted reserves
	Financial assets to liabilities ratio

RELIANCE ON PROPERTY TAXES AND GOVERNMENT GRANTS[2]

Taxes grew from $1.74 billion in 2019 to $1.75 billion in 2021, going from 43% to 45% of total revenue.

Government transfers decreased from $0.72 billion in 2019 to $0.56 billion in 2021, going from 18% to 14% of total revenue.



Definition: Revenue Sources

This indicator measures how much the City depends on property taxes and government grants to fund its programs and services**.**

Why This Matters

The City relies heavily on property taxes, but there is a limit to how much revenue it can collect from its citizens. More diversified revenue streams are generally preferable. Relying on revenue sources such as government grants that are outside the City's control could mean that City services are impacted if the funding is cut.

Management Explanation of Changes

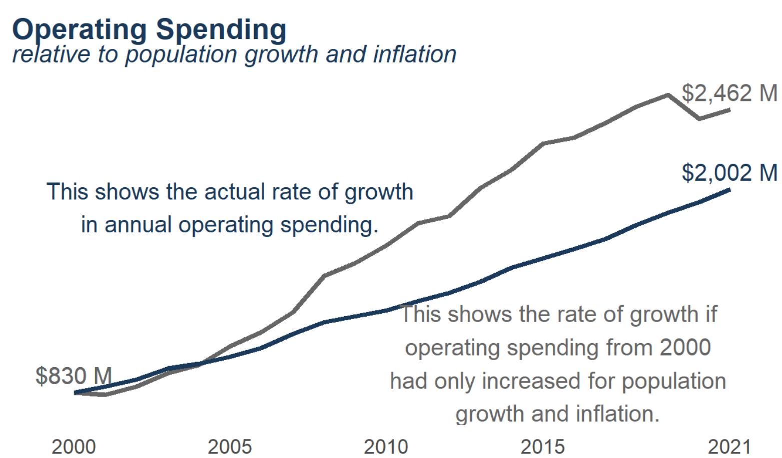
Taxes are the primary method of funding City services. As the City has grown, the cost of providing existing services and the demand for new services has also grown, resulting in an increase in property taxes. The City also made a decision to address its infrastructure deficit through tax-supporting borrowing to fund renewal and the implementation of a dedicated neighborhood renewal levy in 2009.

[2] "Other" revenues include EPCOR subsidiary operations, franchise fees, investment earnings, fines and penalties, licenses and permits, developer and customer contributions, etc.

Government transfers vary widely from year to year as revenue is recorded as eligible expenditures on capital projects are incurred. Over time the City has seen a reduction in grant programs like the Municipal Sustainability Initiative that had broad eligibility criteria and could be used to fund renewal projects and a move to more specific funding to align with Federal and Provincial priorities. In 2020, The City received a significant one-time government grant to offset the impact of the COVID-19 pandemic. A total of $158.2 million was provided through the Government of Canada's Safe Restart funding program in 2020, with matching funding provided by the Province of Alberta through the Municipal Operating Support Transfer (MOST) program.

OPERATING SPENDING RELATIVE TO POPULATION GROWTH AND INFLATION

Operating expenses have increased 22% more from 2000 to 2021 beyond what can be accounted for through population growth and inflation



Definition: Operating Spending

This indicator compares how much the City's actual spending on programs and services has grown versus expected increases due to population growth and inflation. As Edmonton grows and more people require City services, spending would be expected to increase. Similarly, as a result of inflation, it costs more for the City to provide the same programs and services each year.

Why This Matters

When operating spending increases more than population and inflation increases, the City must raise more revenue for each citizen. The cost of services may eventually exceed citizens' ability to pay.

Management Explanation of Changes

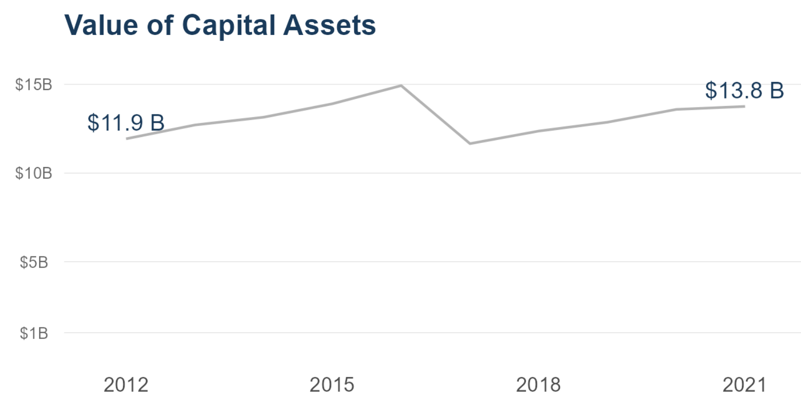
City operating expenses generally grow with population and inflation. Growth greater than population and inflation can be attributed to a number of things:

- *Demand for new services as a result of increasing demand within a growing City including new facilities, roads, and bridges and enhancements to the transit system like LRT.*
- *The cost to address the City's infrastructure deficit through focused capital asset renewal balanced with capital asset growth that required the use of debt to expand the City's capital program resulting in an increase in debt servicing.*

Operating spending declined in 2020 and 2021 relative to 2019 due to the COVID-19 pandemic as the City responded to changing public health guidance that resulted in the closure of facilities and a reduction of certain City services and combined with various expense management strategies necessary to manage the financial impacts of COVID-19.

CHANGE IN VALUE OF CAPITAL ASSETS[3]

The value of the City's capital assets has increased every year from 2000 to 2021 when adjusted for the transfer of drainage assets to EPCOR in 2017. It increased from $12.9 billion in 2019 to $13.8 billion in 2021.



Definition: Capital Assets

This indicator measures the growth of the City's capital assets.

Why This Matters

If the value of the City's capital assets is increasing, this suggests that the City is investing more in new assets and renewing existing assets.

Management Explanation of Changes

As the City continues to grow the net book value of assets also grows. The City continues to expand its capital assets to meet the growing demand of its citizens. The addition of new capital assets and the renewal of existing assets has resulted in an increase in the value of the City's capital assets. The value of the City's capital assets have consistently increased, as additions were greater than disposals and depreciation. The significant decrease in 2017 is related to the transfer of drainage services, and related assets, to EPCOR.

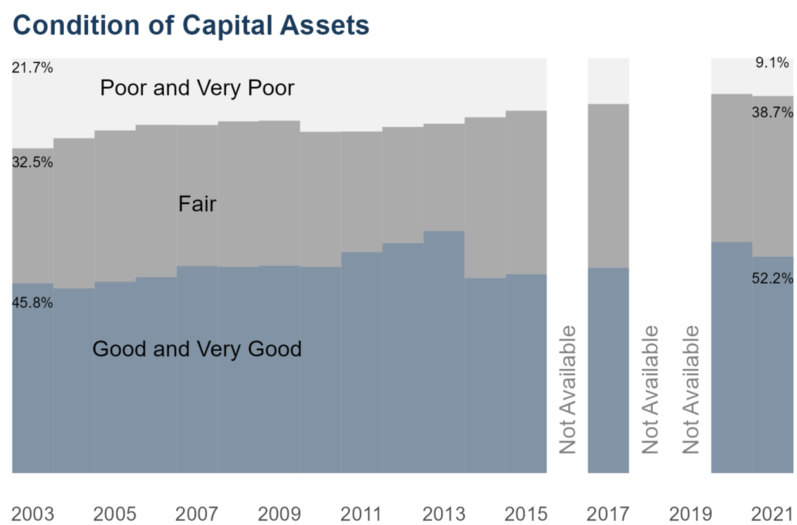
The change in value of capital assets slowed in 2021 compared to 2020, as the Valley Line Southeast project came closer to

[3] The graphic includes only the last 10 years since the City adopted a new accounting standard, *PS3150 - Tangible Capital Assets*, in 2009. Dollar amounts prior to 2021 for capital asset value have been adjusted for inflation (2021 dollars).

completion in 2021 and as a result of less bus fleet deliveries in 2021 compared to 2020.

CAPITAL ASSET CONDITION[4]

The condition of the City's capital assets improved from 2017 to 2021. The proportion of capital assets in poor or very poor condition decreased from 11% to 9%, while those in fair condition remained consistent at 39%.



Definition: Capital Asset Condition

This indicator measures the physical condition of the City's capital assets using a standardized five-point system (Very Good, Good, Fair, Poor, and Very Poor). Physical condition refers to the ability of the asset to meet an intended service level.

Why This Matters

The proportion of assets in each category reflects risk levels around asset failures and financial costs associated with renewal or replacement.

Management Explanation of Changes

Since 2000, the City of Edmonton has made significant investment in the management of its assets. Between 2000 and 2011, asset

[4] Capital asset condition figures prior to 2017 have been adjusted to exclude drainage assets, which were transferred to EPCOR in 2017. The City does not compile capital asset condition data every year.

inventory and condition rating systems were introduced and continually improved. By 2011, asset information was robust enough that quantitative analysis formed the basis for analysis, and the rated condition of ~17% of assets in D&F condition was considered to be an unacceptable level of risk. From this point onward, significant focus was placed on renewal of existing as opposed to building new, which is reflected in subsequent budgets.

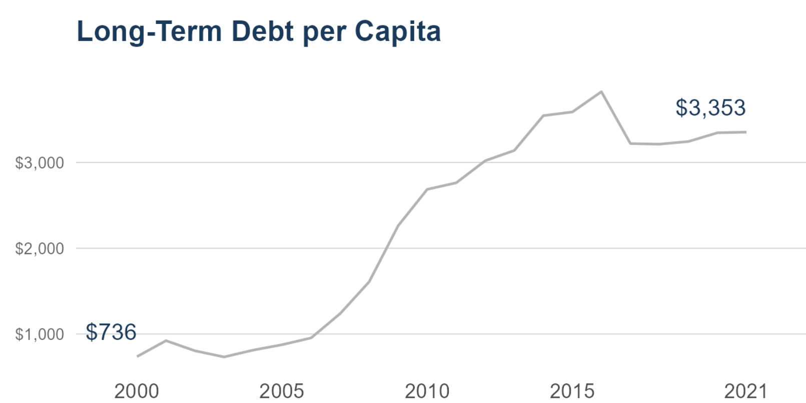
A significant contribution to this decreasing trend in assets rated in D&F condition is the introduction of the Neighbourhood Renewal Program in 2009 which incorporated an incremental tax increase and secured on-going base funding for renewal of neighbourhood roadways. The condition of these assets was worse than the overall average of the City, and based on their relative value to the rest of the City, weighed heavily on the overall City average. An improvement in this asset group results in a significant improvement to the City overall.

The Province's contribution to the City's renewal budget through Municipal Sustainability Initiative beginning in 2007 has also contributed to the improvement with added funding available to support renewal work.

LONG-TERM DEBT PER CAPITA[5]

The long-term debt burden for each citizen has increased from $3,244 in 2019 to $3,353 in 2021.

The decrease in 2017 reflects the transfer of drainage assets to EPCOR.



[5] Dollar amounts prior to 2021 for long-term debt per capita have been adjusted for inflation (2021 dollars).

Definition: Long-term debt per capita

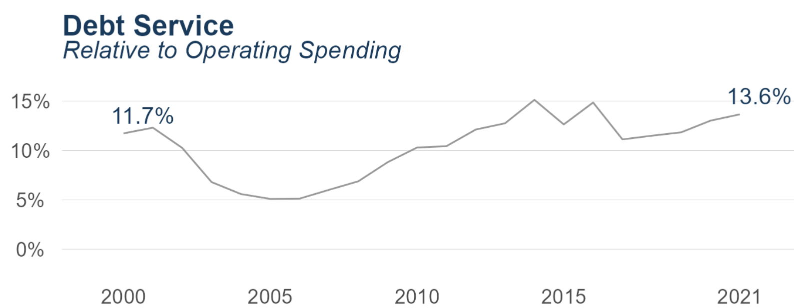
This indicator measures how much debt the City has per citizen that is due for repayment in more than one year.

Why This Matters

A higher debt per citizen increases the risk of overburdening the tax base and less future budgeting flexibility for the City.

DEBT SERVICE RELATIVE TO OPERATING SPENDING

The City's debt service relative to operating spending increased from 12% in 2019 to 14% in 2021.



Definition: Debt Service Relative to operating spending

This indicator measures how much the City is spending to cover interest and principal payments on its outstanding debt each year.

Why This Matters

As the City spends more of its budget on interest and principal for outstanding debt, it decreases the ability to spend on other City programs and services.

Management Explanation of Changes

This explanation applies to two indicators: long-term debt per capita and debt service relative to operating spending.

The City's higher levels of capital spending, particularly since 2007, have led to increased use of debt allowing City to complete capital projects it would otherwise not have been able to afford on a pay-as-you-go basis. While the increase in debt increases the budget as the City is now required to incorporate debt servicing into expenses which results in an increase in taxes. The *use of long term debt for the construction of long term assets provide intergenerational equity meaning that the assets are paid for by the users of the assets over the lifetime of the asset. Administration balances this intergenerational equity acknowledging that too much debt can strain budget and tax resources and reducing future flexibility.*

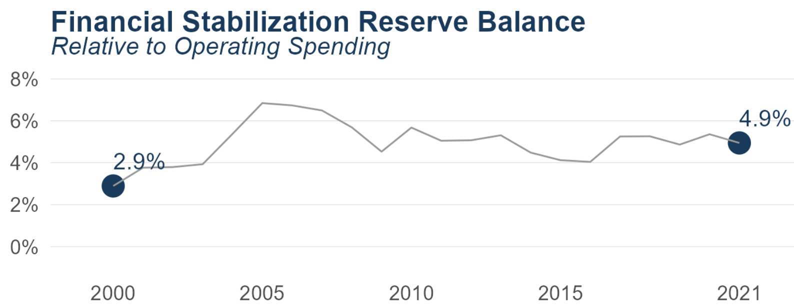
With the focus on both asset renewal and growth of the City, the City's long-term debt per capita and debt servicing as a percentage of operating expenditures has increased with most of the increase attributable to tax-supported debt. While debt per capita grew over the period under the auditor's review, long-term borrowing helped the City's capital assets keep pace in a period of significant growth. Debt financing also allowed the City to receive funding from other orders of government that required matching municipal dollars for significant growth projects. Given that the majority of this debt will require repayment through future taxes, Administration carefully monitors the level of debt and has adhered to the City's Debt Management Fiscal Policy and the Municipal Government Act Debt limit regulation. .

Of note, as the City has taken on additional tax-supported debt to fund capital improvements, and reduced its operating spending in 2020 and 2021 to manage the financial impacts of COVID-19, resulting in debt servicing being a higher portion of total operating expenses.

In 2019, the City's lone credit rating agency, S&P, downgraded the City's credit rating from AA+ to AA. At that time, S&P noted that the downgrade "reflects Edmonton's significant capital spending plans and corresponding growth in debt over the next several years." In 2022, S&P, affirmed its AA rating for the City of Edmonton. The stable outlook reflected S&P's expectation that "the city's execution of the capital plan will not result in a significantly higher reliance on debt or internal resources relative to [their] current expectations''.

FINANCIAL STABILIZATION RESERVE BALANCE RELATIVE TO OPERATING SPENDING

The Financial Stabilization Reserve balance relative to operating spending was 4.9% in 2021, unchanged from 2019.



Definition: Financial Stabilization Reserve Balance Relative to Operating Spending

This indicator measures how much the City has in its financial reserves available to address significant emergent financial issues each year. The unappropriated Financial Stabilization Reserve (FSR) is the City's uncommitted financial reserve.

Why This Matters

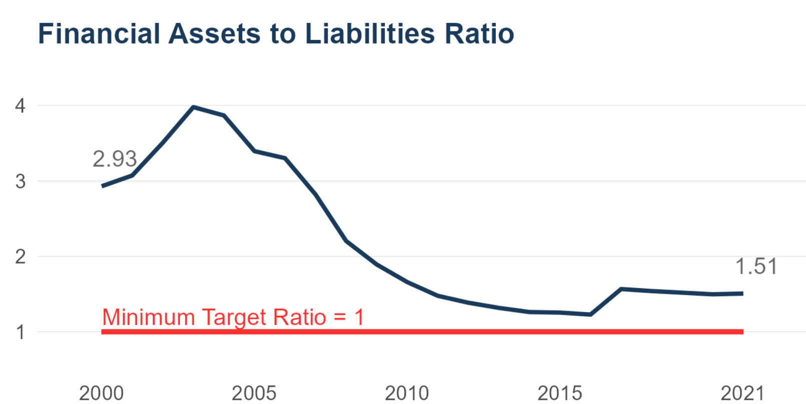
The City's financial reserves impact its ability to withstand financial emergencies.

Management Explanation of Changes

The Financial Stabilization Reserve (FSR) was established in 1997 to provide flexibility in addressing financial risks associated with revenue instability and emergent financial issues, and to ensure the orderly provision of services to residents. The unappropriated balance of the FSR is uncommitted and provides the City with flexibility to address significant emergent financial issues. City policy establishes that the FSR must have a minimum balance of 5 per cent with a target balance of 8.3 per cent of current general government expenses (excluding non-cash amortization). Any annual general government surplus would be applied to the reserve in the subsequent year. Any annual tax-supported deficit would draw on the reserve. City Policy C629, Financial Stabilization Reserve, requires that a risk based review of the unappropriated FSR be completed every three years to ensure the sufficiency of the *minimum and target percentages. Administration conducted a risk-based review of the unappropriated FSR balance in 2021 and confirmed that the respective minimum and target balances of 5 per cent and 8.3 per cent of current general government expenses (excluding non-cash amortization) were appropriate. The year end balance varies from year to year based on the tax-supported year-end position and Council's decision for use of the reserve to meet emergent needs. The past few years have seen the FSR balance stable at just above the minimum balance of 5% of tax-supported expenditures. A large portion of the 2020 tax-supported surplus was set aside within the appropriated FSR to manage the financial impacts of COVID-19 in 2021, resulting in a lower unappropriated FSR balance at the end of 2021.*

FINANCIAL ASSETS TO LIABILITIES RATIO

The ratio of financial assets to liabilities has remained above the City's target ratio. It decreased from 1.52 in 2019 to 1.51 in 2021.



Definition: Financial Assets to Liabilities Ratio

This indicator measures the City's financial resources available relative to its financial obligations. Its financial resources include items such as cash, receivables, and investments. Its financial obligations include items such as accounts payable, deferred revenue, and debt.

Why This Matters

When the City's financial assets increase relative to its liabilities, it has more financial resources on hand to pay for future programs and services.

Management Explanation of Changes

A ratio of less than one indicates that future revenues will be required to pay for past transactions and events. A ratio greater than one indicates that the City has financial resources available to finance future operations. In 2000, the ratio was 2.93. By 2021, the ratio was 1.51. The City's ratio of net financial assets has been consistently greater than one, but has decreased since 2000. The decline of this ratio means that the City has less financial resources to pay for future operations. This decrease in the ratio is consistent with the City's higher levels of capital spending (increase in non-financial tangible capital assets) and greater use of debt (increase in liabilities).

The City's financial assets to liabilities ratio over the past five years has remained greater than one, and has stabilized ranging from 1.50 to 1.57, which reflects the City's ability to pay for its obligations.

The ratio of financial assets to liabilities increased from 1.23 in 2016 to 1.57 in 2017 with the transfer of drainage assets to EPCOR.

The primary components of the financial asset balance are the City's investment of $4,223.4 million in the EPCOR subsidiary, and investments of $2,342.8 million as of December 31, 2021. The largest liability as of December 31, 2021 was long-term debt of $3,546.6 million.

Municipal Comparisons

BACKGROUND

Municipal services and service levels vary across Canada. Some of these differences are due to legislative or structural differences; certain services are provided by a public authority in one city and by the municipal government in another. Other differences in services, as well as service levels, are based on municipal Council policy decisions.

Adjusting municipal data to normalize differences requires significant time and effort, and often internal financial information. A perfect "apples to apples" comparison is not possible with municipal services. Council policies lead to differences in services, service levels, and models of service delivery, regardless of legislative or structural differences.

S&P CREDIT RATING

S&P is a credit rating agency that issues ratings to municipalities on a scale from AAA to D based on their degree of investment risk. Below are the credit ratings issued to a broad selection of Canadian municipalities as of June 2022.

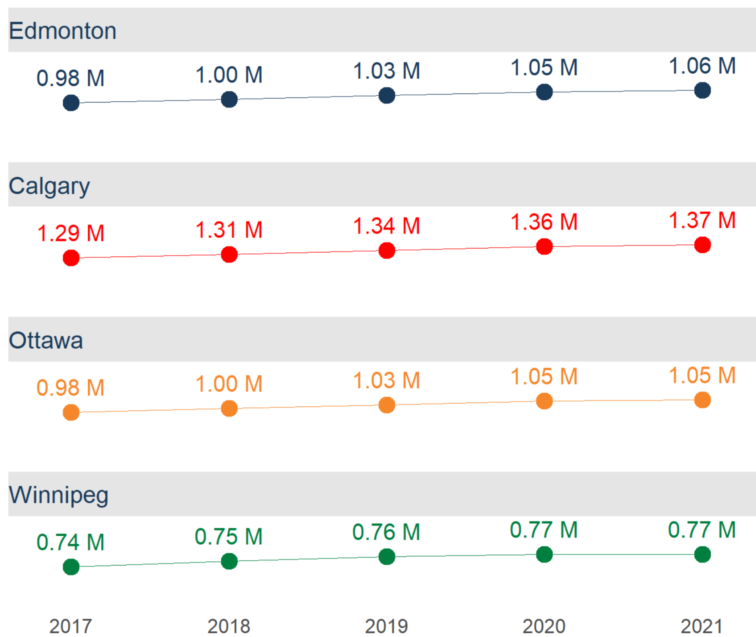
City	Credit Rating
Edmonton	AA
Calgary	AA+
Montreal	AA
Ottawa	AA+
Regina	AAA
Saskatoon	AAA
Toronto	AA
Vancouver	AAA
Winnipeg	AA+

POPULATION

Between 2017 and 2021, Edmonton's population grew by 7.6% compared with 6.2% for Calgary, 7.2% for Ottawa, and 3.6% for Winnipeg.

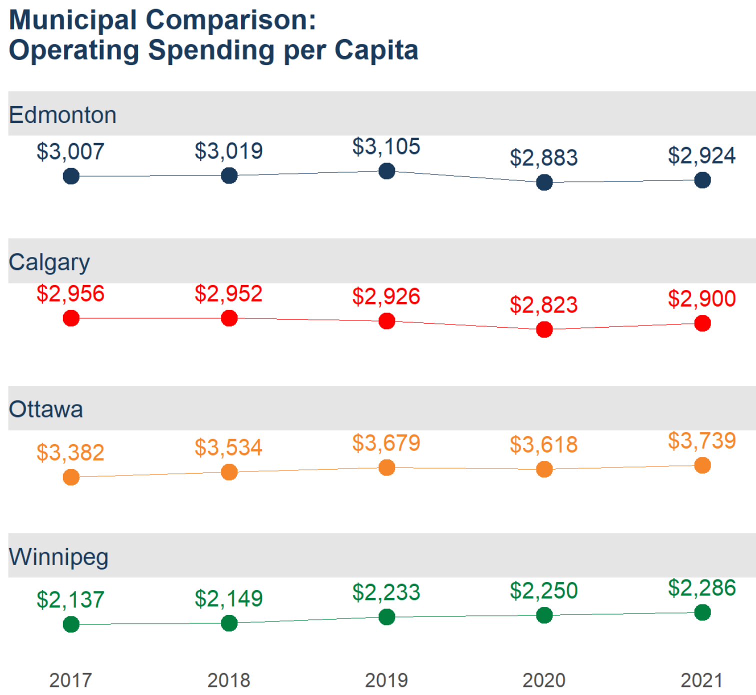
In this report section, a selection of benchmarks are compared against Calgary, Winnipeg, and Ottawa - Canadian winter cities of a similar size to Edmonton. Municipal comparatives for all nine financial indicators are not readily available or reported on a consistent basis, including differences in reporting frequency. The information provided in the following municipal comparisons are actual figures and have not been normalized.

Municipal Comparison: Population



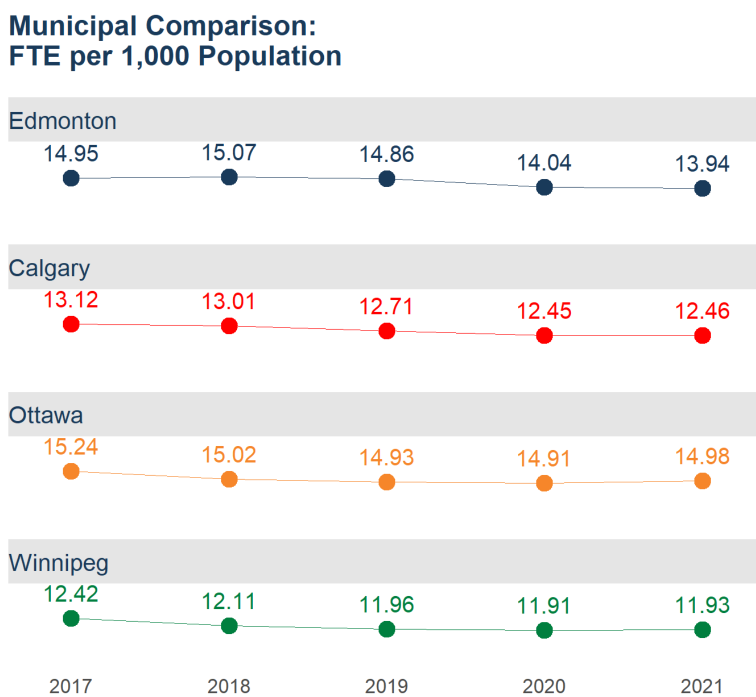
OPERATING SPENDING

The City's operating expenses per capita were 3% higher than Calgary, 35% higher than Winnipeg, and 17% lower than Ottawa (on average between 2017 and 2021).



TOTAL CITY FTE EMPLOYEES PER 1,000 POPULATION

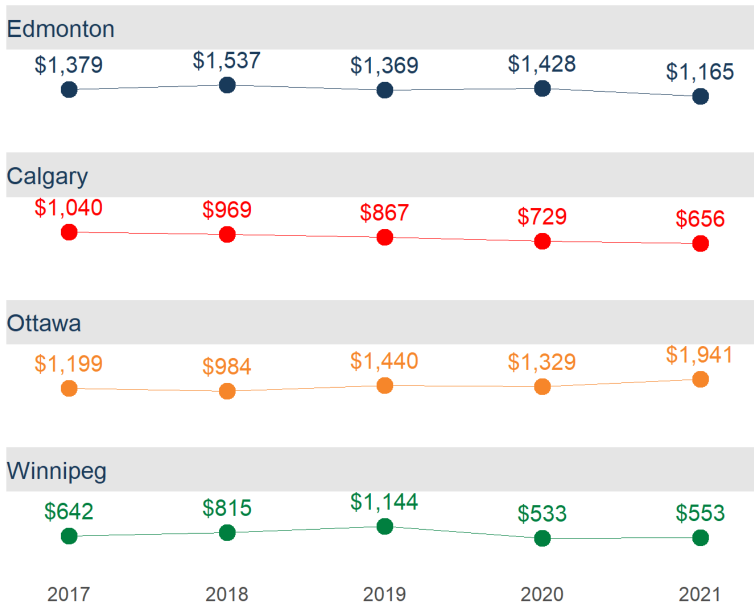
The City's FTE per 1,000 population was 14% higher than Calgary, 21% higher than Winnipeg, and 3% lower than Ottawa (on average between 2017 and 2021).



CAPITAL SPENDING

The City's capital additions per capita were 61% higher than Calgary, 87% higher than Winnipeg, and 0.2% lower than Ottawa (on average between 2017 and 2021).

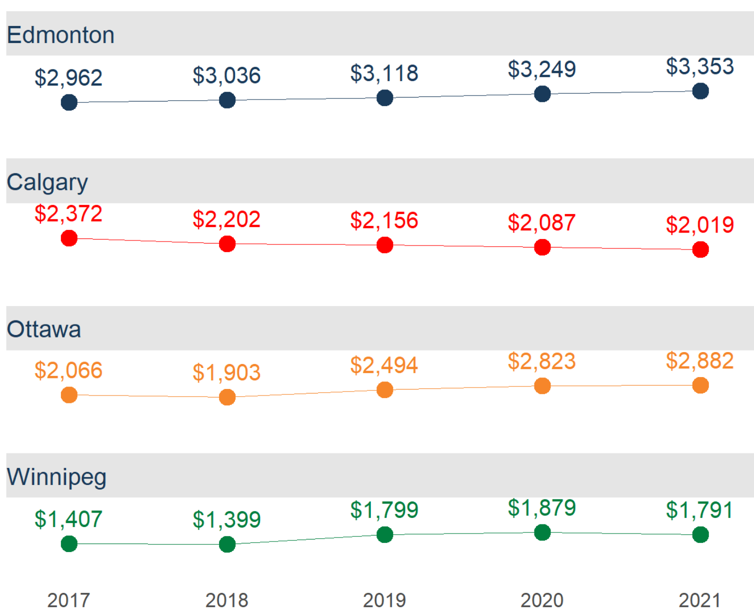
Municipal Comparison: Capital Spending per Capita



LONG-TERM DEBT

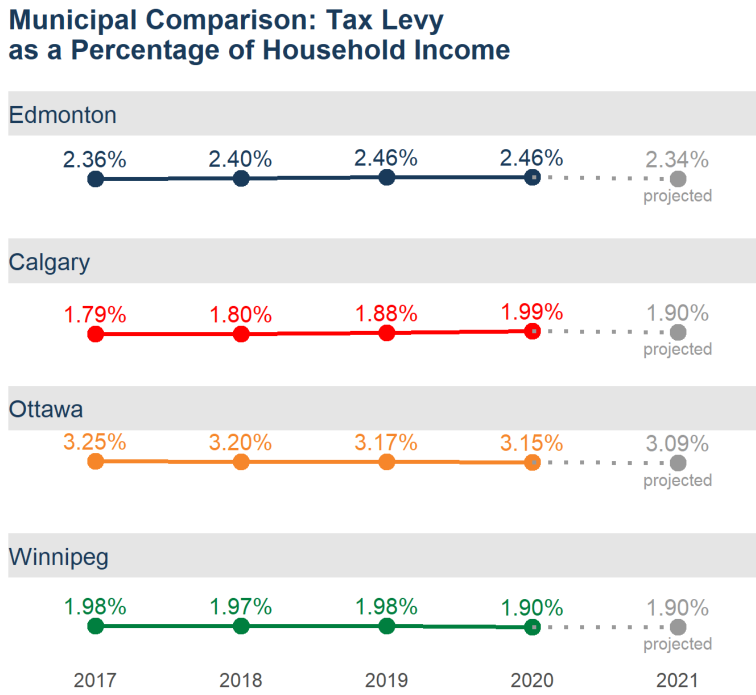
The City's long-term debt per capita was 45% higher than Calgary, 29% higher than Ottawa, and 90% higher than Winnipeg (on average between 2017 and 2021).

Municipal Comparison: Long-Term Debt per Capita



MUNICIPAL TAX LEVY AS A % OF HOUSEHOLD INCOME

The City's tax levy relative to household income was 28% higher than Calgary, 23% higher than Winnipeg, and 24% lower than Ottawa (on average between 2017 and 2021). Statistics Canada reported household income is only available up to the year 2020.



WHY THIS IS IMPORTANT

External comparisons to other municipalities can provide additional context to better understand the City's performance. These comparisons can also support continuous improvement efforts, encourage collaboration and sharing of best practices, and promote accountability for results.

ACKNOWLEDGEMENT

We thank the Financial Services team and supporting staff for their collaboration throughout this project.

Appendix 1 – Methodology

REVENUE

1) Property tax reliance: property tax revenue / total revenue
   a) Total revenue: consolidated total revenue as reported in the annual financial statements including capital revenue
2) Government grant/transfer reliance: government grants/transfers / total revenue

OPERATING SPENDING

3) Operating spending relative to population growth and inflation
   a) Operating spending: consolidated operating expenses less amortization and loss on disposal of tangible capital assets as reported in the annual financial statements
   b) Population growth: change in total Edmonton population (Statistics Canada, Alberta Treasury Board and Finance, and municipal estimate based on federal census)
   c) Inflation: Edmonton Consumer Price Index (CPI)

CAPITAL SPENDING

4) Change in value of capital assets: net book value of tangible capital assets compared to prior year
5) Capital asset condition: physical condition of all City capital assets weighted by replacement value

FINANCIAL POSITION

6) Long-term debt per capita: long-term debt / total Edmonton population
7) Debt service relative to total operating spending: debt service limit used / total operating spending
8) Financial Stabilization Reserve (uncommitted) relative to operating spending: Financial Stabilization Reserve uncommitted balance / total operating spending

9) Financial assets to liabilities ratio: total financial assets / total liabilities