

FINANCIAL SUSTAINABILITY: ADDRESSING BUDGET AND GROWTH CHALLENGES

Recommendation

1. That the August 14, 2024, Financial and Corporate Services report FCS02478, be received for information.
2. That Attachments 2 and 3 of the August 14, 2024, Financial and Corporate Services report FCS02478 remain private pursuant to sections 24 (advice from officials), 25 (disclosure harmful to economic and other interests of a public body) and 27 (privileged information) of the *Freedom of Information and Protection of Privacy Act*.

Requested Action	Information only		
ConnectEdmonton's Guiding Principle	ConnectEdmonton Strategic Goals		
CONNECTED This unifies our work to achieve our strategic goals.	N/A		
City Plan Values	N/A		
City Plan Big City Move(s)	N/A	Relationship to Council's Strategic Priorities	Conditions for service success
Corporate Business Plan	Managing the corporation		
Council Policy, Program or Project Relationships	<ul style="list-style-type: none"> • Multi-year Budgeting Policy (C578) • Fiscal Policy for Revenue Generation (C624) • Debt Management Fiscal Policy (C203C) • The City Plan 		
Related Council Discussions	<ul style="list-style-type: none"> • FCS02361- Spring 2024 Supplemental Operating Budget Adjustment - 2023-2026 Operating Budget, City Council, April 23, 2024 • FCS02483 Budget Update - Non-residential Tax Base Growth Challenges - Executive Committee, June 19, 2024 • UPE01548 Industrial Investment Action Plan - 2024 Update - Executive Committee, June 19, 2024 • UPE02126 Growth Management Framework Update - Substantial Completion Standard - Metrics, Thresholds and Supporting Information - City Council, July 3/4, 2024 		

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Previous Council/Committee Action

At the April 23, 2024, City Council meeting, the following motion was passed:

That Administration provide a report with an action plan and recommendations on how to respond to structural budget issues and growth challenges over the next three supplemental budget adjustments while ensuring the long-term financial sustainability of the Corporation.

Executive Summary

- While the City of Edmonton is in a stable financial condition, ongoing inflationary pressures and evolving service demands require strategic action to ensure long-term financial health.
- Administration is dedicated to balancing the delivery of high-quality services with the financial constraints the City and Edmontonians face.
- Administration has developed action plans to address structural budget issues and will bring some of the recommendations from these plans forward during the Fall 2024 Supplemental Budget Adjustment.
- The financial challenges the City faces are complex and may take several years to address. This will require tough choices to be made between funding these budget pressures through increased property taxes or by reducing service levels, and it will likely take a combination of both strategies to ensure continued financial stability.

REPORT

The City of Edmonton is in stable financial condition. The City has a robust set of financial policies, well-defined budget practices, transparent financial reporting and prudent debt management. On July 11, 2024, the City's AA credit rating was reaffirmed by S&P Global, with a positive outlook. The City's consolidated financial statements are audited annually, provided to Audit Committee and approved by City Council.

In response to the pandemic, the City limited tax increases to provide relief to residents during this unique and challenging period. Edmonton's tax increases during 2019-2022 were some of the lowest among major Canadian municipalities¹. The original approved tax increases for the 2019-2022 budget were 2.6 per cent each year; however, this amount was subsequently reduced to an increase of 1.3 per cent for 2020, a decrease of 0.3 per cent for 2021 and an increase of 1.9 per cent for 2022². These adjustments resulted in annual tax revenues of \$97 million less than the initial approved four year budget. The adjustments were necessary to address uncertainty faced by many Edmontonians.

Like many municipalities, the City of Edmonton is navigating a changing economic and political environment, and, as a corporation, the City is experiencing many of the same inflationary challenges as its residents. The City is facing significantly higher prices for major expenses like fuel, labour, parts and maintenance, which increases the cost to deliver municipal services. The

¹ <https://www.edmonton.ca/sites/default/files/public-files/ResponsesToCityCouncilOperatingBudgetQuestions-SortedByNumber.pdf?cb=1722278175> (page 432)

² <https://www.edmonton.ca/sites/default/files/public-files/2022BudgetHighlights.pdf?cb=1722280256> (page 5)

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cost pressures are compounded by significant population growth which places additional demand on City services. Between 2019 and 2023 (four years), Edmonton's population grew 10 per cent. However, between 2022 and 2023 alone (one year), Edmonton's population growth was 5.1 per cent.³

To maintain financial sustainability, the City must address budget pressures and growth challenges. Administration continues to seek a balance between delivering the services that Edmontonians rely on and keeping property taxes and user fees manageable. Through service satisfaction research⁴ Administration understands that individuals have differing opinions on the services that the City of Edmonton should deliver to enable a good quality of life for all Edmontonians. The choices needed to achieve this balance are challenging; Edmontonians value many different City services based on their individual needs and expectations. For instance, the transit service provides affordable access for Edmontonians to move around the community and region. The City also has programs like the Ride Transit Program and Leisure Access Program that ensure equitable access for all Edmontonians. When the cost to provide services increases faster than the tolerance for tax increases, adjustments to services are required.

In the midst of substantial population growth, the post-pandemic financial impacts persist. Administration is addressing these financial pressures, seeking efficiencies and, wherever possible within its delegated authority, implementing action plans. In previous years, there was some flexibility within the City's budget to offset unfavourable budget variances in one area with favourable budget variances in another. The limited amount of flexibility that once existed has diminished and many of these favourable budget variances no longer exist due to the rising costs to deliver service and multiple years of budget reduction exercises. The accumulation of pressures has become impactful on the City's overall financial position, as indicated by the 2023 year-end deficit (tax-supported operations ended 2023 with a \$40.1 million deficit, which is 1.2 per cent of the 2023 operating expenditure budget). The action plans outlined in Attachment 1 and 2, highlight the contributing factors to the deficit that persist into 2024 and will continue to put pressure on the Financial Stabilization Reserve until the underlying causes are addressed.

Administration continues to analyze the interconnections between the operating and capital budgets. The operating budget is experiencing increased financial pressure due to the lack of renewal funding in the capital budget. Lack of renewal funding in the capital budget leads to increased costs for maintenance in the operating budget; aging infrastructure waiting for renewal often costs more to maintain and is at a higher risk of requiring costly repairs or requiring total replacement. Likewise, shortfalls in the operating budget resulting in inability to maintain at appropriate levels decreases the life of assets and places a heavier burden on the renewal budget. While the focus of this report is on addressing structural budget variances within the tax levy operating budget, many of these same budget pressures persist in the capital and utility budgets, and the agencies, boards and commissions that are partially funded by tax levy.

³ Calculations are based on July 1 population estimates that come from the Alberta Treasury Board and Finance Office of Statistics and Information's May 2024 version of municipal population estimates.

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<https://www.edmonton.ca/sites/default/files/public-files/ServiceSatisfactionSurvey2023-ServiceReport.pdf?cb=1722282561>

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Responding to Structural Budget Issues and Growth Challenges

Addressing structural budget variances

As budgets are estimates of revenue and expenses, variances are expected. However, recurring and unaddressed unfavourable variances can erode the financial sustainability of an organization. Structural budget variances are recurring deficits or surpluses that can be attributed to an event or circumstance that fundamentally changed business operations. An example of a structural budget variance is the shift in fare-purchasing behaviour and travel pattern changes which impacted transit revenues which was discussed in the May 23, 2024 City Operations report CO02390 Ride Transit Program Funding Update. These shifts include increased demand for discounted/subsidized fare products and the reduction in some office commuters as a result of hybrid or virtual work arrangements. These changes have altered short-term revenue projections and require adjustments to long-term financial planning.

Addressing structural budget variances requires an approach to resolve their systemic impact, as they are not temporary or timing-related discrepancies that will balance over time. Instead, they require analysis to identify and address their root cause.

Attachments 1 (public) and 2 (private) identify structural budget variances and corresponding actions plans to address the issue across the organization. The action plans are plans to address the existing issues in the budget. The structural budget variances are categorized by their root cause as either:

- *inflationary pressures* - the general increase in prices related to fuel, parts, maintenance and services;
- *revenue shortfalls* - where actual revenue realized has been less than budgeted, such as transit and On-Street Construction and Maintenance (OSCAM) revenues;
- *external factors* - for matters that are out of the City's control such as vandalism or extreme weather; or
- *Administration or Council directed* - for variances that have been directed by either Administration or Council.
 - An example of Administration-directed is item A1-28 in Attachment 1, where Administration is disposing of properties to rightsize its real estate portfolio and address significant long term capital renewal liabilities. While this program is in the long term financial best interest of the City, it creates short term budget variances due to the foregone lease revenues.
 - An example of a Council-directed item is Council's approval of Policy C556C on July 4, 2024, requiring procurements for contracted services to continue to include a requirement to pay a living wage to all employees performing work in City facilities.

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<i>Annual net budget variance \$000s favourable/unfavourable</i>	Attach 1 (Public)	Attach 2 (Private)	Total	Tax levy impact
Inflationary	(23,931)	0	(23,931)	1.1%
Revenue Shortfalls	(19,015)	(159)	(19,174)	0.9%
External Factors	(18,198)	(3,170)	(21,368)	1.0%
Administration or Council directed	(10,419)	(13,218)	(23,637)	1.1%
Total	(71,563)	(16,547)	(88,110)	4.1%

Each structural budget variance includes an action plan outlining the work to find a solution for each issue. These action plans specify the steps and timeline for identifying the detailed solutions through the next three supplemental operating budget adjustment (SOBA) processes.

In many cases, actions to remedy the budget are not immediate; rather, the focus is on aligning actual expenditures with the budget once identified solutions are implemented. Administration is conducting a variety of actions to remedy the budget variances including initiating program reviews, completing cost of service studies, exploring methods to increase revenues and examining service delivery options. The length of time to implement action plans and realize the expenditure reductions will vary, with some implementation taking two to three years.

In cases where no other alternatives are available and service level adjustments are required, Administration will reduce service levels to align spending with the approved budget. If a service level must be reduced, Administration will advise Council of the financial impacts should Council desire to maintain the existing level of service through an addition to the tax levy. If all of the structural budget variances were addressed through tax levy funding, the tax levy would increase by an additional 4.1 per cent tax levy increase for 2025. The “next steps” section of this report provides an overview of the structural budget items that are recommended to be remedied as part of the Fall 2024 Supplemental Operating Budget Adjustment.

Addressing long-term growth challenges

While the action plans included in Attachment 1 and 2 are targeted to address existing issues in the budget, Administration is also working to address future long-term growth challenges by making changes to budget and other decision-making processes.

There are numerous initiatives underway that will contribute to improving financial sustainability, including:

- Identify the total cost of ownership of infrastructure before making final investment decisions, including:
 - Developing consistent methodologies/processes for estimating and monitoring operating impacts of capital (OIC).
 - Improving business case development to capture OIC and total cost of ownership (design, build, maintenance, renewal costs).

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- Embedding OIC evaluation at relevant decision points, which will act as a communication vehicle to operations to add these new assets to their ongoing inventory and to earmark operational funds.
- Developing new strategies/policies that outline changes to infrastructure must capture operational impacts (both human and financial resources) so that decision makers can review prior to approving the strategies.
- Refresh the Integrated Infrastructure Management Planning (IIMP) process: This tool currently calculates estimated projected lifecycle costs of infrastructure and revenue in new neighbourhoods as part of area and neighbourhood statutory plan approvals. Administration is undertaking a renewal of the IIMP process in alignment with The City Plan and Council direction to improve fiscal outcomes of new neighbourhoods. The outcomes of the updated IIMP process are intended to better inform the City budget process for capital, operating and renewal impacts of City funded and contributed assets.
- Focus on increasing industrial development through the implementation of the nine actions in the Industrial Investment Action Plan. This will include pre-planning for the future growth area.
- Understand the cost of growth in the future growth area and determine how growth can be achieved efficiently and sustainably in alignment with The City Plan by considering new funding approaches.

Mitigating budget challenges

Since 2015, Administration has found efficiencies and savings without significantly impacting services. As reviewed in the following table, there have been several reduction and efficiency programs which resulted in nearly \$1.9 billion in cumulative savings and cost avoidance measures.

ANNUAL (\$ millions)	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Total
2% Initiative	\$16	\$46	\$80	\$127	\$127	\$127	\$127	\$127	\$127	\$127	\$1,031
2019-2022 Budget Reductions	0	0	0	0	21	31	35	38	38	38	202
4/3/2/1% (2019-2022)	0	0	0	0	13	18	30	43	43	43	189
2020 Budget Reductions	0	0	0	0	0	30	34	37	37	37	174
2021 Budget Reductions	0	0	0	0	0	0	50	59	59	59	228
2023-2026 Budget OP-12 Amendment	0	0	0	0	0	0	0	0	15	15	30
Total	\$16	\$46	\$80	\$127	\$162	\$206	\$276	\$304	\$319	\$319	\$1,854
Tax Increase Equivalent	1.2%	2.2%	2.3%	3.0%	2.2%	2.7%	4.1%	1.6%	2.1%	0.1%	21.5%

As financial pressures arise, Administration first seeks to mitigate impacts by finding efficiencies elsewhere to manage the impacts or adjusting the way services are delivered to enhance efficiency. This forms part of the ongoing continuous improvement that occurs across the organization to deliver services amidst evolving factors and new challenges.

Administration proactively mitigates future budget challenges where possible and shifts resources to address key priorities. This occurs throughout the organization. Some branch-level examples include:

- Economic Investment Services (Urban Planning and Economy) reprioritizing operating budgets and reallocating resources from programs with favourable budget variances, such as the Storefront Improvement Program and the Corner Store Program, to partially fund critical

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initiatives such as the Industrial Investment Action Plan and the Downtown Implementation Plan 2025.

- Fleet and Facility Services (City Operations) shifting internal staff to critical areas that need additional work, specifically the large recreation centres.

Administration will continue to mitigate budget challenges while implementing the action plans to find solutions that will address the structural budget variances identified, alongside balancing service delivery, limiting tax increases and maintaining financial sustainability.

Economic Adjustments

Included in the structural budget variances are economic adjustments that will need to be addressed in the Fall 2024 SOBA, including fuel, parts inflation and facility maintenance inflation. These variances will be included in Administration's recommended SOBA due to the corporate-wide impacts these budget variances have to services like emergency services, transit, snow and ice, and spring sweep. These services do not have the ability to further absorb any inflationary increases associated with these items.

Service level reductions are not possible for these budget variances due to:

- regulatory standards that could not be achieved without funding,
- compromising safety and operational integrity of some facilities and infrastructure assets;
- existing legislated and scheduled preventative maintenance levels cannot be sustained, leading to imminent and significant service disruptions; and
- imminent grounding of some fleet, including a significant impact to transit.

Further details of these impacts are identified in Attachment 1.

Community Insight

The October 31, 2022 Communications and Engagement report CE01489 Budget 2023-2026 Community Insights provided details on the extensive engagement Administration conducted on the 2023-26 capital and operating budgets during the summer of 2022. The City engaged with the general public, organizations and community groups, and harder-to-reach communities, tailoring the engagement approach to each group. Themes that emerged included:

- Containing Costs: Participants shared their concerns about escalating costs of living and the resulting pressure placed on businesses, families and individuals. While participants did not indicate strong comfort levels with raising taxes, members of partner and stakeholder groups were more supportive of the idea than the general public.
- Transit and connectivity: Participants shared a need to improve transit service, accessibility and connectivity throughout Edmonton, as well as concerns around the safety of using transit.
- Community Safety: The City received comments about what some perceived to be increasing crime and violence within Edmonton, and expressed a need to focus on improving community safety coming out of the pandemic.
- Social Supports and Government Responsibilities: Participants shared that supports are needed for those most vulnerable in our communities, including affordable housing, and addiction and

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mental health supports. Participants raised a concern about the overlapping nature of federal, provincial and municipal responsibilities. Concerns raised over social supports do not necessarily equate to an expectation for the City to take on all the responsibility.

- **Efficiency and Innovation:** Participants said they want the City to be transparent in demonstrating efficiency and innovation in service delivery. They asked that the City work at finding efficiencies, streamlining our operations and identifying new revenue streams.
- **Culture Building and Celebration:** Edmontonians want to connect with each other and support the arts and culture that make Edmonton unique. They value culture building and community amenities, including libraries, parks and gathering places.

These themes continue to inform Administration's decision-making and recommendations to Council on budget adjustments. The comments about containing costs and a lack of comfort with tax increases were shared in 2022 after a long period of low property tax increases. Administration anticipates that these concerns have likely grown after a prolonged period of high inflation and higher tax increases.

The annual Service Satisfaction Survey gathers Edmontonians' perceptions of overall service quality and the satisfaction and importance of highly visible City services. The results from 2023⁵ indicated the majority of Edmontonians are satisfied with the overall quality of City services. Participants showed less interest in increasing investment in City services compared to the previous (and first) year of the survey. Results from 2024 will be shared in fall 2024.

GBA+

The four-year budget incorporated input from extensive public engagement. This engagement applied a GBA+ approach to do targeted outreach and ensure the City captured input from residents experiencing unique barriers and challenges, and those whose voices are heard less often. Administration conducted targeted outreach and engagement with 2SLGBTQ+ community members, non-English speakers, youth, seniors, racialized community members, women, people with disabilities, Edmontonians experiencing or at risk of homelessness, and people experiencing mental health and addiction challenges.

GBA+ is applied on the project, service or profile that make up each of the budget adjustments. As part of the development of the 2023-2026 Proposed Operating Plans and Budget, departments and GBA+ Centres of Excellence participated in a partial GBA+ process and identified differential impacts that new initiatives proposed for the next four years might have on Edmontonians. For example, would a proposed program impact single parents one way and seniors another way?

These GBA+ insights will be used to help determine the impacts of recommended solutions from the action plan and ensure these impacts are weighed as part of the implementation process.

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<https://www.edmonton.ca/sites/default/files/public-files/ServiceSatisfactionSurvey2023-ServiceReport.pdf?cb=1721943883>

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Attachments

1. Action Plan for addressing structural budget variances (Public)
2. PRIVATE - Action Plan for addressing structural budget variances (Private)
3. PRIVATE - Financial Strategies Update