

2018 Financial Statement Discussion and Analysis

INTRODUCTION

The Annual Report provides information regarding the use of financial resources entrusted to the City of Edmonton for the purpose of providing municipal services and infrastructure.

In addition to providing an overview of the City's 2018 financial performance and position, this report describes significant fiscal policies, strategies and plans related to financial control, accountability, long-term sustainability and risk management.

The 2018 Annual Report includes the City's consolidated financial statements (financial statements), which have been prepared in accordance with Canadian public sector accounting standards (PSAS). KPMG LLP has audited the City's financial statements and provided an Independent Auditor's Report. The financial statements and auditor's report satisfy the legislative reporting requirement set out in the *Municipal Government Act* (MGA) of Alberta.

The following financial statement discussion and analysis should be read in conjunction with the financial statements. Both have been prepared by, and are the responsibility of, the City of Edmonton's leadership team. A five year statistical review of key information has also been provided.

2018 FINANCIAL HIGHLIGHTS

The City ended the 2018 year with a \$2.4 million operating deficit for general government (tax-supported) operations relative to the overall expense budget. The deficit is primarily a result of external factors that were beyond the City's control; lower than budgeted gas franchise fees, lower grants in lieu of taxes from the Province and higher fuel costs as a result of price increases. The City became aware of these factors during the year and was able to proactively manage costs to offset the unfavourable financial impacts of these external factors. As a result, the City ended the year with a tax-supported deficit of \$2.4 million. This is equal to negative 0.1 per cent of budgeted tax-supported expenses, the lowest percentage variance in the last ten years.

The final year of the City's four-year capital budget for 2015-2018 saw continued investment in major capital initiatives, including new and upgraded libraries, a police campus, bus fleet replacement and refurbishment, and recreation facility renewals and upgrades. The 2015 - 2018 capital budget also allocated funding to construct new transportation assets such as LRT expansion projects, a transit garage, and roads and bridges. The previous capital budget also included funding for infrastructure reconstruction, such as streetscapes and sidewalks, as part of the neighbourhood renewal program.

In 2018, the City continued to execute its business plan and budget. The 2018 operating budget saw a property tax increase of 3.2 per cent to pay for civic programs, including 1.4 per cent dedicated to fund neighbourhood renewal, 1.0 per cent dedicated to the Edmonton Police Service, and 0.6 per cent dedicated to fund the Valley Line LRT, in alignment with City Council's (Council) priorities.

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In December 2018, City Council approved new four-year operating and capital budgets for 2019-2022, aligning the City's multi-year operating and capital budgets for the first time. The 2019 - 2022 capital budget balances investments in infrastructure that are required to keep existing City assets in good repair with the financial support required to address the City's ongoing growth needs.

The 2019–2022 operating budget is influenced by economic forecasts that predict slow-to-moderate growth in Edmonton as Alberta recovers from the 2015-16 recession. The City endeavours to balance affordable taxes and reasonable user fees with achieving program results, maintaining services for the general public, and balancing the interests and values of the public.

With an overall accumulated surplus of \$14,296.5 million, the City's financial position is healthy. The City will continue to monitor its financial performance and the broader economy, and will implement strategies to address growth and increased service demand through the multi-year budget process. These challenges are expanded upon in the Long-Term Sustainability section of this discussion.

FINANCIAL POSITION

Consolidated Statement of Financial Position

(millions of \$)

	2018	2017	2016	2015	2014
Financial Assets	\$ 7,237.7	\$ 6,791.5	\$ 5,715.8	\$ 5,325.2	\$ 5,061.7
Liabilities	4,699.5	4,334.4	4,652.7	4,244.1	4,010.4
Net Financial Assets	\$ 2,538.2	\$ 2,457.1	\$ 1,063.1	\$ 1,081.1	\$ 1,051.3
Non-Financial Assets	11,758.3	10,842.2	13,638.9	12,666.6	11,841.0
Accumulated Surplus	\$ 14,296.5	\$ 13,299.3	\$ 14,702.0	\$ 13,747.7	\$ 12,892.3

The City ended the year in a strong financial position with **net financial assets** of \$2,538.2 million, an overall increase of \$81.1 million compared to 2017. The primary components of the net financial asset balance are the City's investment of \$3,749.1 million in the EPCOR subsidiary, investments of \$1,872.3 million, cash and cash equivalents of \$852.0 million, and long-term debt of \$3,046.2 million. Net financial assets have grown steadily since 2014 due to capital appreciation on the City's investment holdings and the City's investment in EPCOR, resulting in a healthy and stable net financial asset position.

The City's **non-financial assets** at the end of 2018 were \$11,758.3 million, an overall increase of \$916.1 million compared to 2017. Non-financial assets are comprised primarily of tangible capital assets such as buildings, roadways, and vehicles that are valued at \$11,687.0 million. The City's non-financial assets have grown over the last five years due to continued investments in infrastructure; these investments include the construction of new infrastructure to meet the needs of a growing population and repairs to existing infrastructure to maintain the service standards that Edmontonians expect. The ability to build and maintain infrastructure assets ensures that Edmonton can provide services and remain an attractive and cost-effective place to live and do business.

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Accumulated surplus is an indicator of the City’s overall financial health that reflects the net economic resources the City has built up over time. The City ended 2018 with a total accumulated surplus of \$14,296.5 million, an increase of 7.5 per cent compared to prior year. This surplus includes the City’s equity in tangible capital assets, investments in the EPCOR subsidiary and Ed-Tel Endowment Fund, and a number of reserves, including the Financial Stabilization Reserve. The City maintains a healthy accumulated surplus balance due to its continued investments in Edmonton’s infrastructure, its growing investment in EPCOR and the accumulation of annual excess of revenues over expenses.

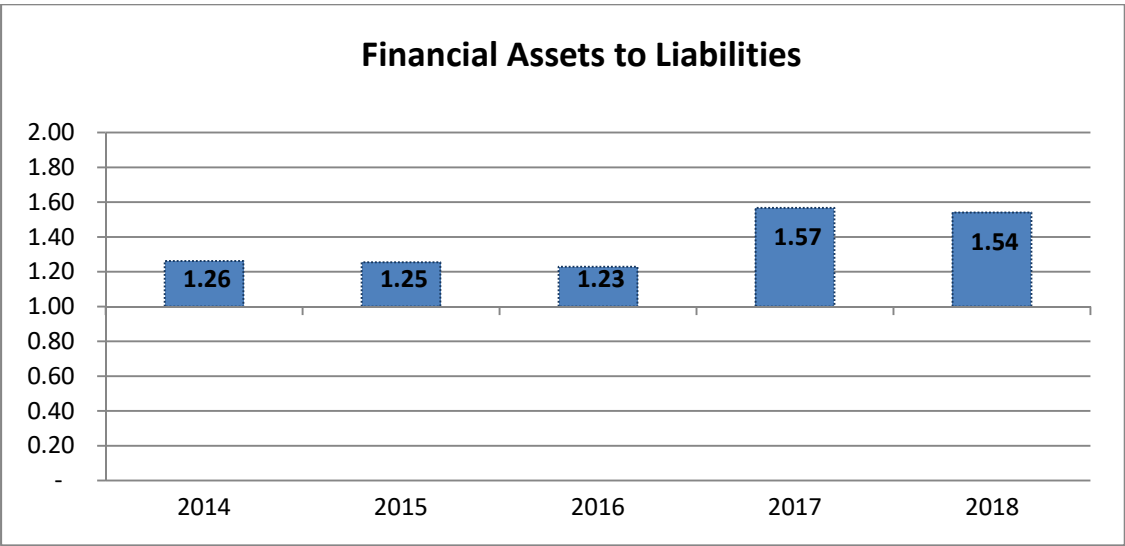
In 2017, City Council approved the transfer of the net assets and operations of the City’s Drainage Utility to EPCOR, effective September 1, 2017. This transfer resulted in a decrease in the City’s net financial assets, non-financial assets, and accumulated surplus in that year. In 2018, the City’s financial position returned to the growth trend seen prior to the Drainage Utility transfer in 2017.

Refer to the Statistical Review section of the annual financial report for additional trending and other statistical data.

The significant balances and changes in financial position are discussed in the following sections.

FINANCIAL ASSETS

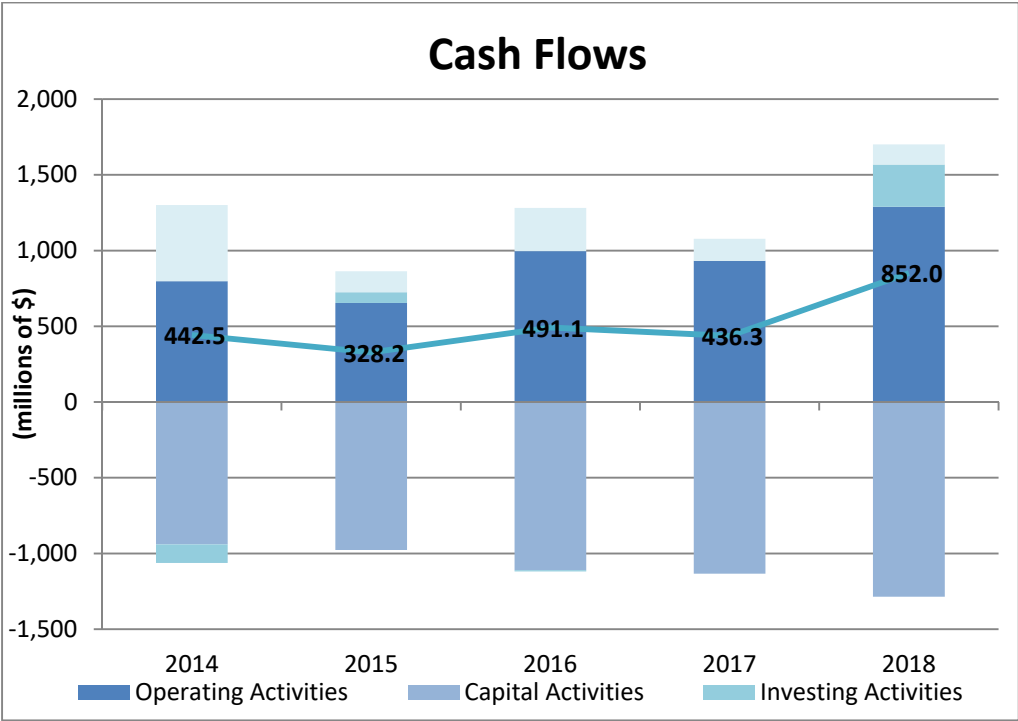
The financial assets-to-liabilities ratio is used to assess the sustainability of the City’s financial position. A result lower than one indicates that future revenues will be required to pay for past transactions and events. A result higher than one indicates that financial resources that can pay for future operations are available in the present. The City’s financial assets to liabilities ratio over the past five years has remained greater than one.



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Cash

The City’s cash position includes both cash and cash equivalents such as temporary investments. In 2018, the City’s cash position increased to \$852.0 million from \$436.3 million in 2017, an overall increase of \$415.7 million. The change is due to the timing differences between expenditures and funding sources and is consistent with the decrease in trade and other receivables and the increase in both accounts payable and accrued liabilities. In 2018, the cash and cash equivalents used to finance some 2017 capital expenditures as an interim measure were partially replenished through borrowing and through capital government transfers paid to the City by other orders of government.



The Consolidated Statement of Cash Flows summarizes the sources and uses of cash by the City in 2018. During the year, the City raised \$1,289.2 million from operations and \$133.9 million from net financing activities. The City spent \$1,285.7 million to acquire tangible capital assets, net of proceeds on disposal, and generated \$278.3 million in cash through investing activities, including a dividend from the EPCOR subsidiary of \$166.0 million during the year.

Receivables

Receivables include amounts owed to the City related to the following categories: trade and other; local improvements; and taxes and government transfers. The 2018 receivables balance of \$482.9 million decreased by \$53.6 million from the prior year balance of \$536.5 million. Trade and other, local improvement and taxes receivables decreased by \$36.1 million due to normal operating fluctuations. Government grant receivables decreased by a net \$17.5 million compared to prior years as a result of timing differences between expenditures

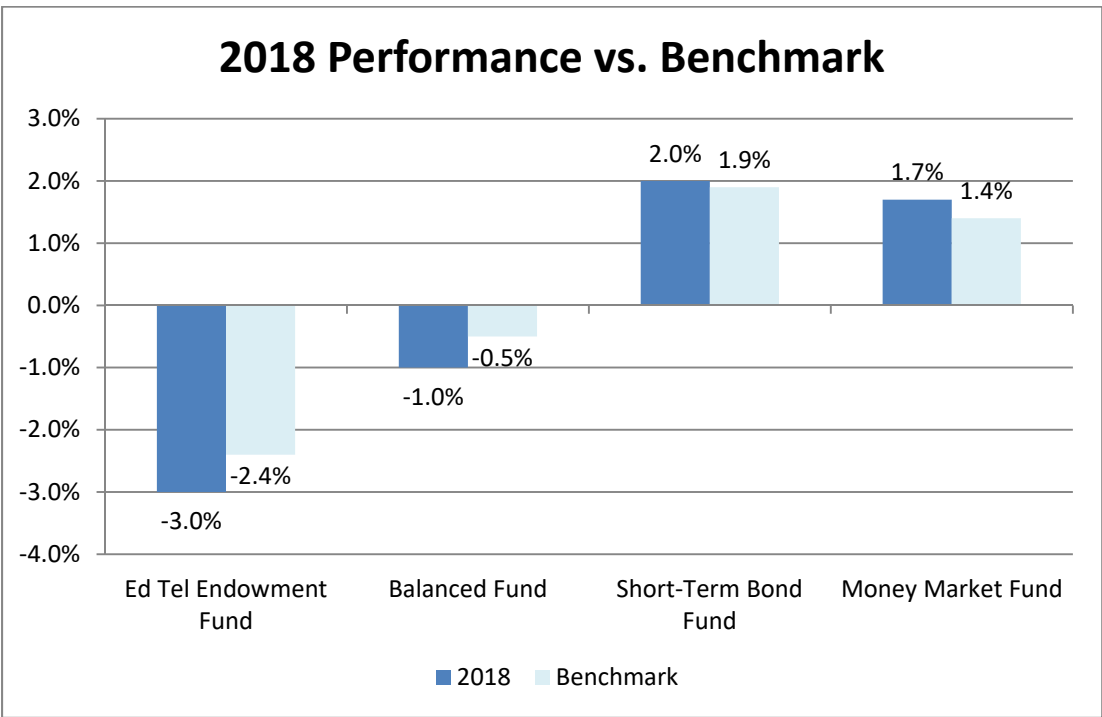
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related to the Valley Line LRT Southeast project and reimbursement of those expenditures through grant funding. From 2016 to 2018, design and construction work on the Valley Line LRT Southeast project has progressed. At the end of 2017, the City was owed \$96.7 million in grant funding through the Green Transit Incentives Program for eligible expenditures incurred for the Valley Line project during the year, and these funds were received in 2018. Currently, the City is owed \$82.7 million from the P3 Canada Fund for expenditures incurred for the Valley Line LRT Southeast project from 2016 to the end of 2018. The P3 Canada Fund grant will be paid to the City upon service commencement of the Valley Line LRT Southeast project at the end of 2020. As a result, the grant receivable amount will grow in line with eligible expenditures until that time. Details on federal and provincial government transfers are provided in Note 18 to the financial statements.

Investments

All investments held by the City must comply with the MGA, the *Major Cities Investment Regulation*, and the City’s internal investment policy. The objective of the Council-approved investment policy, as overseen by the Investment Committee, is to preserve the principal investment amount and maximize investment returns within an acceptable and prudent level of risk. Asset mix is determined based on investment earnings objectives, investment time horizon, and level of risk tolerance.

The Investment Committee’s role is to oversee the City’s investments. Members are selected to bring both investment and business expertise to the Committee. By monitoring the City’s investment program and implementing changes as necessary, the Committee ensures that the funds are well positioned and appropriately invested in a manner that meets their objectives.



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Included in investments of \$1,872.3 million are amounts held as cash, amounts (payable) receivable, fixed income, common and preferred shares, pooled infrastructure funds, and other investments. These investments are held within the Money Market Fund, Short-Term Bond Fund, the Balance Fund and the Ed Tel Endowment Fund.

The Money Market Fund ensures that sufficient cash and liquid assets are available to cover the City's short-term obligations. As such, the fund is solely invested in money market securities with time horizons of one year or less, depending on the City's forecast of commitments.

The Short-Term Bond Fund is an investment vehicle for working capital that is not currently needed to fund City operations but will be needed in less than five years. Therefore, the fund holds fixed income securities with an investment horizon of less than five years.

The Balanced Fund is a long-term investment vehicle to fund capital on a pay-as-you-go basis. Because it has a longer-term investment horizon of greater than five years, it has a risk tolerance that permits owning equities.

The largest of the City investment funds is the Ed Tel Endowment Fund, established in 1995, with the investment of \$465.0 million in proceeds from the sale of the municipal telephone utility. The Ed Tel Endowment Fund provides a source of income in perpetuity while ensuring that the real purchasing power of the original investment is maintained. Similar to the Balance Fund, the Ed Tel Endowment Fund has a longer-term investment horizon and a level of risk tolerance that permits owning equities. City Bylaw 11713 establishes the formula under which earnings from this fund can be applied to fund City operations.

Since 1995, the Ed Tel Endowment fund has contributed \$784.1 million to the City. In 2018, the fund contributed \$46.0 million in dividends to the City, including a \$9.2 million special dividend that was approved by City Council on December 6, 2017. In accordance with Bylaw 11713, City Council may authorize a special dividend payment when the market value of the fund is more than 15 per cent above the inflation adjusted principal. At June 30, 2018, the market value of the Ed Tel Endowment Fund was 17.6 per cent above the inflation adjusted principal. On September 4, 2018, City Council approved a special dividend from the Ed Tel Endowment fund in the amount of \$9.7 million to be paid in 2019. The special dividend will fund capital projects, in alignment with the City's budget strategy of redirecting investment earnings to capital.

Performance of the City's investment funds ranged from negative 3.0 per cent (Ed Tel Endowment Fund) to 2.0 per cent (Short-Term Bond Fund), depending on each fund's asset mix. In contrast to the strong performance seen during the two previous years, equity markets around the world declined in 2018. Considerable political uncertainty, rising interest rates and a slowing global economic expansion were key factors in the negative returns seen in foreign equity markets throughout the year. Canadian equities experienced negative returns of 8.9 per cent during the year, given an uncertain growth outlook and ongoing weakness in the price of oil and the Canadian dollar. The price of oil and the Canadian dollar fell by 25 per cent and 8 per cent respectively, marking the first time since the financial crisis in 2008 that all major equity markets posted negative returns. As a result, the Ed Tel Endowment Fund and Balance Fund, both of which are invested in equity markets in accordance with

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the City's investment policy, saw returns below their respective benchmarks. By contrast, the Money Market Fund and Short Term Bond Fund, which are invested in less risky fixed income securities, performed in line with or above benchmarks. The Ed Tel Endowment Fund ended 2018 with an investment book value of \$825.0 million, compared to a market value of \$787.6 million.

Overall, the market value of the City's investment portfolio at year end was \$1,804.2 million, 3.6 per cent below the investment cost. Forecasts indicate positive returns in equity markets in 2019 and over the longer term. The City considers the decline in the value of its investments to be temporary in nature.

More detailed information about the investment performance and benchmarks are available in the 2018 Investment Committee Annual Report on the City of Edmonton's website.

The City's investment custodian, State Street Trust Company, is responsible for the safekeeping of the City's investments. The City selected State Street Trust Company was selected as its investment custodian in 2008. In 2018, the City reviewed its banking and investment custodian services and State Street Trust Company was retained as the City's investment custodian. The City undertakes a review of banking and custody services on a periodic basis.

The City established the Sinking Fund so that monies could be regularly set aside for the eventual redemption of various public debenture issues (borrowings). The last outstanding debenture issue of \$100.0 million matured in 2018 and the related Sinking Fund assets were sold to repay the remaining outstanding debentures. At the end of 2018, the Sinking Fund has no remaining assets and there are no longer any outstanding public debenture issues.

Additional investments are managed for trust assets under administration's control, including City sponsored pension plans and a long-term disability benefit plan funded by employees. Consistent with public sector reporting standards, trust assets that are not owned by the City are excluded from the reporting entity. Note 21 to the financial statements provides summary disclosures with respect to trust assets under City administration.

Investment in EPCOR

EPCOR builds, owns and operates electrical, natural gas and water transmission and distribution networks, as well as water and wastewater treatment facilities, sanitary and stormwater systems, and infrastructure in Canada and the United States. EPCOR also provides electricity, natural gas and water products and services to residential and commercial customers.

The City applies a modified equity method of accounting and reporting for EPCOR, a wholly owned subsidiary, as a government business enterprise. EPCOR's management has prepared their 2018 consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). EPCOR's accounting principles are not adjusted to conform to those used by the City as a local government; therefore, inter-organizational transactions and balances are not eliminated.

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In 2018, the City's investment in EPCOR increased to \$3,749.1 million from \$3,560.9 in 2017, a net increase of \$188.2 million. The net increase is due to EPCOR's reported net income of \$295.2 million for 2018 and other equity adjustments of \$59.0 million, offset by a dividend of \$166.0 million paid to the City. Summary financial information for EPCOR is included in Note 20 to the financial statements.

Additional detail on EPCOR's strategies, financial performance and health, and significant events that occurred in 2018 are discussed in EPCOR's 2018 Annual Report, which is available on the company's website.

LIABILITIES

Accounts payable and Accrued Liabilities

Accounts payable and accrued liabilities include the categories of trade and other, developer obligations, payroll and remittances and accrued interest amounts owing. The balance of \$867.7 million at year-end has increased over the prior year balance of \$771.2 million by \$96.5 million.

The trade and other category has increased by \$83.0 million due to timing differences in the payment of outstanding invoices over prior year and an overall increase in capital expenditures compared to prior years. In particular, there was a \$50.2 million increase in the P3 service commencement liability to be paid in 2020 to TransEd (the P3 partner) upon service commencement of the Valley Line LRT Southeast. The liability increases annually until final payment upon service commencement based on percentage of project completion.

Developer obligations have increased by \$31.0 million over prior year as a result of significant land development projects that began in 2018. This resulted in an increase in related developer payments being held pending fulfillment of requirements set out in land development service agreements.

Payroll and remittance liabilities have decreased by \$18.1 million over the prior year. A majority of this variance is related to timing differences in the payment of payroll deduction amounts that are collected by the City and owed to the Receiver General at the end of the year compared to prior years. The variance was partially offset by an increase as a result of a salary accrual for a contract agreement that expired and was in negotiations at the end of 2018.

The remainder of the variance was within accrued interest. Information on the composition of the accounts payable and accrued liability balance is provided in Note 7 to the financial statements.

Deferred Revenue

Deferred Revenue is largely made up of government transfers provided to fund operating and capital expenditures. The use of these revenues is externally restricted until used for the purposes intended. The deferred revenue balance of \$493.2 million increased by \$120.1 million from the prior year balance of \$373.1 million. This increase is attributed to the new provincial Climate Leadership Plan Grant for the Valley Line LRT and Municipal Sustainability Initiative (MSI) grant proceeds received in advance of eligible expenditures.

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Additional details about balances and changes in deferred revenue are included in Note 8 to the financial statements.

Long-Term Debt

The City uses debt to finance capital expenses under the principles and limits established by the City's Debt Management Fiscal Policy (DMFP). The policy supports the City's long-term capital plans and strategies while maintaining long-term financial affordability, flexibility and sustainability. The policy also provides for approval of multi-year debt guidelines with a corresponding debt repayment funding strategy, and added flexibility for the application of funds used for debt servicing once debt is retired.

The City has three main types of long term debt obligations: tax-supported debt funded by tax levy, self-supporting tax-guaranteed debt funded through dedicated non-tax levy revenues, and self-liquidating debt funded through programs that are self-sustaining, such as the Waste Services Utility, the Blatchford Redevelopment Project and local improvements. As self-supporting tax-guaranteed debt is guaranteed by the tax levy, it is classified as tax-supported debt. Tax-supported debt also includes the City's long term obligation related to its public-private partnership (P3) with TransEd for the construction of the Valley Line LRT Southeast (P3 term debt).

The City's policies and strategies with respect to debt management are documented in a Debt White Paper that is available on the City of Edmonton's website. The Debt White Paper discusses the City's use of debt financing to optimize resources dedicated to the acquisition, creation, and rehabilitation of infrastructure.

Since 1993, borrowing completed by the City has generally been in the form of amortizing debentures in Canadian dollars administered through the Alberta Capital Finance Authority (ACFA), using the debt rating of the Government of Alberta and combined borrowing volumes across Alberta. Interest rates are established at the time of borrowing and remain constant throughout the term of the debenture, eliminating the risk associated with fluctuating interest rates. Repayments are made annually or semi-annually. The City continued to benefit from low interest rates for new borrowing during the year, with ranges as follows:

Borrowing Terms and Interest Rates

Term	Interest Rates
5 years	2.13% to 2.92%
10 years	2.53% to 3.20%
15 years	2.77% to 3.36%
20 years	2.92% to 3.45%
25 years	3.00% to 3.51%
30 years	3.16% to 3.53%

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The City's net long-term debt was \$3,046.2 million at December 31, 2018, an increase of \$134.1 million (4.6 per cent) compared to the 2017 balance. Long-term debt is comprised of debentures, mortgages and the P3 term debt. The gross amount of debentures, mortgages payable and P3 term debt of \$3,664.1 million is offset by \$617.9 million in amounts receivable from EPCOR. The amount receivable from EPCOR is for debentures issued in the name of the City on behalf of EPCOR relating to the Gold Bar Wastewater Treatment Facility (transferred to EPCOR in 2009) and the Drainage Utility (transferred to EPCOR in 2017).

Debt Schedule

(millions of \$)

	Tax-Supported	Self-Liquidating	Total Debt (net)
Opening	\$ 2,381.3	\$ 530.8	\$ 2,912.1
Borrowings	228.0	48.0	276.0
Increase in P3 term debt	99.8	-	99.8
Principal Payments	(114.0)	(127.7)	(241.7)
Ending	\$ 2,595.1	\$ 451.1	\$ 3,046.2

Of the total net long-term debt of \$3,046.2 million, \$2,595.1 million is tax-supported and \$451.1 million is self-liquidating. Tax-supported debt includes \$188.7 million of P3 term debt related to the portion of deferred capital costs owing to TransEd from 2020 to 2050 for the construction of the Valley Line LRT Southeast. Term debt is based on the percentage of project completion as of December 31, 2018.

During the year, the City added a total of \$276.0 million through new debenture borrowings and mortgages; \$228.0 million is considered tax-supported and \$48.0 million is considered self-liquidating. Self-liquidating borrowings during the year include \$17.6 million for the Blatchford Redevelopment Project, \$16.1 million for the Waste Services Utility, and \$14.3 million related to local improvement projects. Tax-supported debt was borrowed to finance various capital projects, including the Northwest Police Campus construction, land acquisition for the Valley Line West LRT Line, Blatchford District Energy System, revitalization of the Stanley A. Milner Library, Walterdale Bridge and construction of the Kathleen Andrews Transit Garage.

Debt principal repayments of \$241.7 million were made during the year, comprising \$114.0 million for tax-supported debt and \$127.7 million for self-liquidating debt.

The City of Edmonton is subject to limits of total debt and debt servicing by the MGA, RSA 2000, c M-26. The MGA Debt Limit Regulation AR 255/2000 stipulates that the City's total debt limit is two times the revenue of the municipality, and that debt servicing costs is limited to 35 per cent the revenue of the municipality. The revenue for the purposes of this calculation is the consolidated revenue of the City less capital government transfers and contributed tangible capital assets and excludes revenue from EPCOR. Debt servicing, for the

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purposes of calculating the MGA debt servicing limit, is the amount of principal and interest for the subsequent year relating to debt in place at the end of the year reported.

Debt and Debt Service Limits - MGA

(millions of \$)

	2018	2017	2016	2015	2014
Debt limit	\$ 5,587.4	\$ 5,649.4	\$ 5,627.4	\$ 5,556.1	\$ 5,139.1
Debt limit used	\$ 3,046.2	\$ 2,912.1	\$ 3,339.0	\$ 3,033.2	\$ 2,895.7
Percentage used (%)	54.5	51.5	59.3	54.6	56.4
Debt service limit	\$ 977.8	\$ 988.6	\$ 984.8	\$ 972.3	\$ 899.3
Debt service limit used	\$ 284.3	\$ 264.6	\$ 341.0	\$ 285.8	\$ 319.4
Percentage used (%)	29.1	26.8	34.6	29.4	35.5

The City's debt level in comparison the MGA debt limit provides a measure of the future revenue required to pay for capital financed through debt in the past. The City's level of debt is well below the legislated limit established in the MGA and has been relatively stable. Over the past five years, the debt limit has ranged from 51.5 per cent to 59.3 per cent of the established debt limit, indicating the City holds a sustainable level of debt. Debt has been used strategically to move priority capital projects ahead and to capitalize on low interest rates. The City's debt servicing in comparison the MGA debt servicing limits indicates the extent to which past borrowing decisions constrain the City's ability to meet its financial and service commitments in the present. The City's debt servicing limits over the past five years have remained well below the established limit.

Debt is further restricted through the City's DMFP, which limits total debt servicing to 22 per cent of City revenues, and tax-supported debt to 15 per cent of annual tax-supported revenues. In monitoring compliance with the DMFP, debt servicing is defined as debt principal and interest paid in the year. The City DMFP debt servicing limits are below the limits established in the MGA. The percentage of the debt servicing limit used for purposes of the DMFP increased in 2017 due to the final repayment of \$60.0 million of short-term borrowing. The City undertook short-term borrowing to finance fast-tracked capital expenditures for projects with approved funding through Municipal Sustainability Initiative grants and the provincial fuel tax.

Debt Service Limits - DMFP

(millions of \$)

	2018	2017	2016	2015	2014
Total debt service limit	\$ 614.6	\$ 621.4	\$ 619.0	\$ 611.2	\$ 567.0
Debt service limit used	269.7	\$ 333.0	\$ 262.0	\$ 304.3	\$ 299.4
Percentage used (%)	43.9	53.6	42.3	49.8	52.8
Tax-supported debt service limit	\$ 380.0	\$ 361.9	\$ 348.6	\$ 331.0	\$ 310.1
Debt service limit used	\$ 219.0	\$ 264.1	\$ 170.8	\$ 218.8	\$ 215.3
Percentage used (%)	57.6	73.0	49.0	66.1	69.4

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NON-FINANCIAL ASSETS

Tangible Capital Assets

Tangible capital assets are managed and held for use in the production or supply of goods and services, for rental to others, for administrative purposes or for development, construction, maintenance or repair of other tangible capital assets. The economic lives of these assets extend beyond a year and are not for sale in the ordinary course of operations.

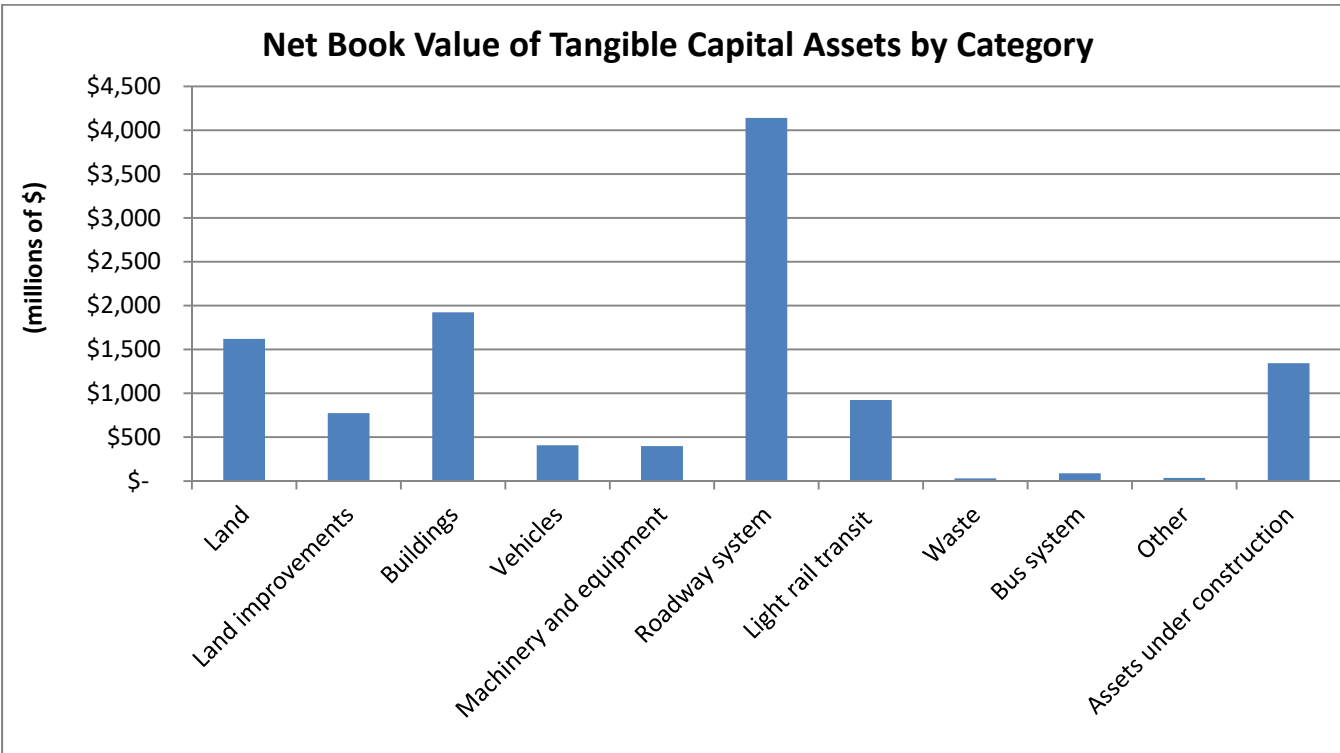
Tangible capital assets of \$11,687.0 million have increased by 8.9 per cent compared to the 2017 balance of \$10,728.0 million. The net increase of \$959.0 million is a result of acquisitions of tangible capital assets of \$1,290.5 million, contributions of tangible capital assets of \$203.9 million and reclassification of \$47.4 million in Other assets to Tangible capital assets, related to transfer of the EXPO Center and Northlands Coliseum to the City as discussed further below. This increase was partially offset by annual amortization of \$533.7 million and disposals and transfers of assets with a net book value of \$49.1 million.

On December 5, 2017, City Council approved the termination and release of the EXPO Center loan agreement between the City and Northlands, effective January 1, 2018. A Staged Surrender Agreement was also approved by City Council transferring ownership of the EXPO Center and Northlands Coliseum to the City, effective January 1, 2018, and Northlands Park later in 2018. During the year, the City forgave the EXPO Center loan agreement, previously classified as Advances secured by tangible capital assets within Other assets, in consideration for the EXPO Center, Northlands Coliseum and Northlands Park. The outstanding amount of the advance of \$47.4 million was reclassified to tangible capital assets. Contributed tangible capital assets of \$82.5 were recognized for the remaining value of the EXPO Center, Northlands Coliseum and Northlands Park based on the estimated fair market value on the date of the asset transfer.

Tangible capital assets placed in service were primarily in the asset categories of buildings and roadways. Schedule 1 - Consolidated Schedule of Tangible Capital Assets to the financial statements provides a continuity schedule for the asset cost and related accumulated amortization for each significant asset type.

City Council approved the 2015 - 2018 capital budget in December 2014. During the fourth and final year of the 2015-2018 capital budget, capital spending during the year focused on key growth projects and infrastructure maintenance. The capital additions and contributions of \$1,541.8 million in 2018, compared to \$1,355.5 million in 2017, shows the City's continued commitment to investing in city infrastructure to accommodate both growth and renewal. The capital additions of \$1,290.5 million in 2018 were the largest in comparison to any previous year in recent history. Roadways continue to be the largest asset category with a net book value of \$4,139.7 million. These are followed by buildings and land for future municipal purposes, with a net book values of \$1,923.7 million and \$1,621.6 million, respectively.

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In 2018, the City made progress on significant capital projects such as the neighbourhood renewal program, roadway systems across the City, construction of the Kathleen Andrews transit garage, Northwest Police Campus, Stanley A. Milner Library and the Valley Line LRT Southeast.

Reserves

The City’s Council-approved reserve policy, City Policy C217D Reserve and Equity Accounts, directs the establishment of and processes related to reserves. Establishing reserves and transferring funds to and from reserves requires Council’s approval.

In accordance with the City Policy C217D, the City completed a review of reserves in 2018. This review is completed at minimum once every three years and ensures that City reserves continue to support the City’s financial goals and serve the highest priority needs of the City and its residents. As a result of the 2018 review, City Council approved the establishment of several new reserves that are described as follows:

- The Sanitary Servicing Strategy Fund (SSSF) Reserve manages the funds related to the SSSF program. The SSSF is a mechanism that combines the resources of developers, the new home construction industry and EPCOR Drainage to fund the construction of major sanitary trunks to service growth within the city and in new development areas.
- The Developer Recoveries Reserve manages recoveries from external developers to reimburse the City for cost-shareable front-end construction costs for development where the City was the initial developer.

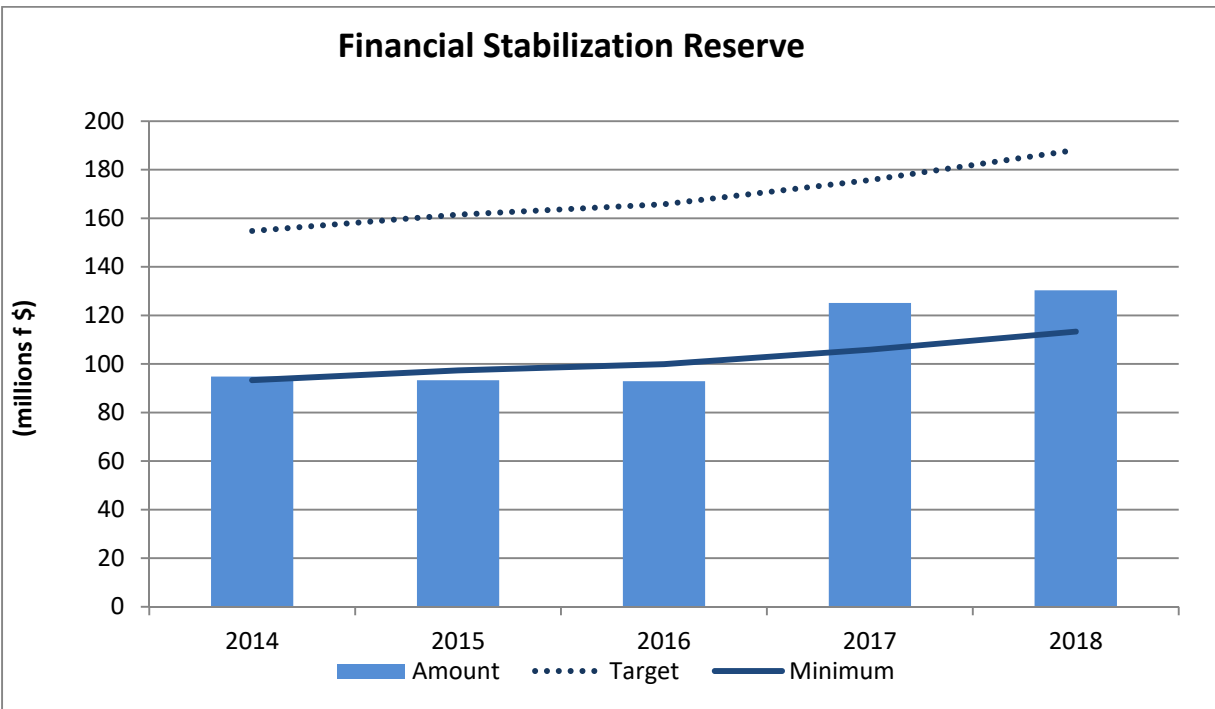
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- The Pay-As-You-Go Capital Reserves manage tax-levy and other operating sources for capital project funding.

The SSSF, Developer Recoveries and Pay-As-You-Go capital funds were previously recorded to Advances for construction within the Accumulated surplus. The City formally established these capital funds as reserves to increase transparency for users of the financial information, including City Council. The reallocation of these funds from Advances for construction to Reserves has resulted in an overall increase in the Reserve balance and a corresponding decrease in Advances for construction compared to prior year. Through the reserves review, City Council formally closed the Aggregate Site Development and Land Reclamation Reserve due to changes in business operations. The general reserve policy and balances are monitored on an ongoing basis, with the next formal review planned for 2021.

In 2018, City Council approved City Policy C604, Edmonton Police Services (EPS) Funding Formula. This funding formula will provide funding certainty to allow for long-term budgeting and workforce planning. In line with the funding formula, City Council also approved the establishment of an EPS Reserve fund through City Policy C605 to allow for the management of police operational surpluses and deficits over the long term. One hundred per cent of any annual EPS operating surplus will be placed in the reserve, and 100 per cent of any annual operating deficit will be drawn from the reserve. The reserve will also fund the EPS operating and capital requirements in adherence with the related reserve policy. Further discussion of the funding formula and reserve is provided for in the Financial Control and Accountability section.

A schedule of reserves has been provided in Note 15 to the financial statements. The reserve balance of \$721.8 million at the end of 2018 has increased by \$287.8 million over the prior year balance of \$434.0 million. As previously mentioned, the net increase was primarily the result of \$257.4 million in new reserves approved as part of the 2018 Reserves Review, where balances were previously included as Advances for construction within the Accumulated surplus. The overall reserve balance includes reserves of the City of Edmonton Library Board, Edmonton Economic Development Corporation, Non-Profit Housing Corporation, and Fort Edmonton Management Company, as approved by their respective Boards.



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 citizens. The appropriated balance of the reserve represents funds that have been set aside by City Council to fund future commitments. The FSR is uncommitted and provides the City with flexibility to address significant emergent financial issues. The reserve is not intended to be used to stabilize future tax rate increases. 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.

In 2018, Administration conducted a risk-based review of the FSR as required by City Policy C217D Reserve and Equity Accounts, and concluded 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 policy requires that a risk-based review of the FSR be completed every three years to ensure the sufficiency of the minimum and target percentages.

As of December 31, 2018, the FSR balance is \$130.3 million. During the year, the general government surplus from 2017 of \$31.2 million was transferred to the reserve, \$13.6 million net funding was transferred to the appropriated balance to fund future project expenses, and \$12.5 million was transferred to the Planning and Development Reserve (previously referred to as Current Planning Reserve) to replenish the funds that had previously been transferred from the reserve to support tax-supported operations. The City will draw \$7.6 million from the FSR in 2019 to offset the 2018 tax-supported operating deficit of \$2.4 million and to fund \$5.2 million in 2018 operating projects that were not completed by year-end and that have outstanding

2018 Financial Statement Discussion and Analysis

commitments in 2019, as approved by City Council. During the 2019-2022 budget deliberations, Council approved a tax-smoothing strategy that will see \$25.4 million drawn from the FSR from 2019-2021 to fund operating expenditures, with a full repayment back to the reserve in 2022. As part of the strategy, \$7.4 million will be drawn from the reserve in 2019.

The City's general reserve procedures do not allow for the FSR to be used to offset or stabilize tax-levy increases on a permanent basis. However, the FSR can be used to smooth tax rate increases over a budget cycle if the funds are eventually replenished. After reflecting the approved transactions noted above, the reserve balance of \$115.2 million will exceed the minimum level as set in City Policy C217D--currently \$113.4 million--but will be below the target level of \$188.2 million.

The appropriated balance as of December 31, 2018 is \$68.1 million. Throughout 2018, City Council approved \$28.9 million in funding from the appropriated balance to fund future project expenses, and \$37.6 million was withdrawn to fund expenses. Amounts within the appropriated FSR of \$8.3 million were released back to the FSR as the funding was no longer required.

As of December 31, 2018, the City had six reserves that were in deficit balances. The City maintains reserves that are used to accommodate differences between expenses and related funding sources. These include the Neighbourhood Renewal, Interim Financing, Community Revitalization Levy and Brownfield Redevelopment Reserves. In accordance with City Policy C217D Reserve and Equity Accounts, reserves that are expected to have deficit balances will only be established if future funding to offset the deficit balance has been identified at the time of the reserve's creation. A review of the City's deficit reserve balances was included as part of the 2018 Reserves Review and confirmed that all reserves are performing consistent with long-term plans, with existing shortfalls to be recovered through future funding sources.

FINANCIAL OPERATIONS

The Consolidated Statement of Operations and Accumulated Surplus outlines revenues earned by the City and their application (expenses) to provide municipal services.

Consolidated Statement of Operations

(millions of \$)

	2018 Actual	2017 Actual	2016 Actual	2015 Actual	2014 Actual
Operating Revenues	\$ 3,050.3	\$ 3,023.8	\$ 3,043.2	\$ 2,926.4	\$ 2,674.8
Capital Revenues	941.8	687.0	758.7	636.9	487.7
Operating Expenses	3,029.4	2,956.1	2,836.6	2,764.0	2,604.8
Excess of Revenues over Expenses	\$ 962.7	\$ 754.7	\$ 965.3	\$ 799.3	\$ 557.7

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Consolidated revenues exceed expenses for the year by \$962.7 million after accounting for government transfers for capital, contributed tangible capital assets, developer and customer contributions for capital and local improvements. Operating revenues have remained fairly consistent, with a majority of revenue coming from property taxes, user fees and the City's growing investment in EPCOR. Capital revenues vary from year to year based on fluctuations in development activities and timing of significant capital projects. Expenses over the past five years reflect the demand for additional services and infrastructure that comes with a growing population. Tax-supported expenses have been increasing with the growth in taxable property assessments, indicating that expenses are growing at a consistent and sustainable rate with the economy.

In 2017, City Council approved the transfer of the City's Drainage Utility to EPCOR, effective September 1, 2017. The financial results for 2017 include Drainage Utility revenues and expenses up to August 31, 2017, while it was still being managed and operated by the City.

Significant year-over-year variances and variances from budget are discussed in the following sections.

OPERATING REVENUES

Operating Revenues

(millions of \$)

	2018 Budget (A)	2018 Actual (B)	Variance (B-A)	2017 Actual (C)	Variance (B-C)
Net taxes available for municipal purposes	\$ 1,594.7	\$ 1,592.0	\$ (2.7)	\$ 1,505.8	\$ 86.2
User fees and sales of goods and services	677.0	633.1	(43.9)	696.4	(63.3)
Subsidiary operations - EPCOR	272.8	295.2	22.4	256.3	38.9
Franchise fees	168.4	158.4	(10.0)	159.7	(1.3)
Government transfers - operating	107.4	113.0	5.6	107.5	5.5
Fines and penalties	94.8	87.7	(7.1)	90.1	(2.4)
Licenses and permits	75.7	74.8	(0.9)	75.7	(0.9)
Investment earnings	83.9	66.5	(17.4)	116.9	(50.4)
Developer/ customer contributions - operating	34.7	29.6	(5.1)	15.4	14.2
Operating Revenues	\$ 3,109.4	\$ 3,050.3	\$ (59.1)	\$ 3,023.8	\$ 26.5

Comparison to Budget

Operating revenues were lower than budget by \$59.1 million, or 1.9 per cent of the revenue budget, due to lower than budgeted revenue from user fees and sales, less than expected investment earnings, and lower than budgeted franchise fees that were partially offset by greater than budgeted net income for EPCOR.

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User fees and sales were lower than budgeted because of fewer than expected land sales due to market conditions and development for civic use, and fewer land sales related to the Blatchford Redevelopment because of delays in the start of construction. The lower than budgeted revenues were partially offset by unbudgeted revenue earned by the Edmonton Economic Development Corporation from assuming operations of the EXPO Centre in 2018.

Investment earnings were less than anticipated because equity markets around the world experienced a decline in 2018. Considerable political uncertainty, rising interest rates and a slowing global economic expansion were key factors influencing negative returns.

Franchise fees were lower than budget based on a revision to the gas franchise fee delivery rate, on which the franchise fee is calculated.

Comparison to Prior Year

Overall, operating revenues increased by \$26.5 million from the prior year due to an increase of \$86.2 million in taxation revenue from a combined rate increase and growth, and an increase of \$38.9 million in EPCOR earnings, partially offset by a decrease of \$63.3 million from user fees and sales of goods and services and \$50.4 million lower investment earnings. There was a net increase of \$15.1 million from various other revenue sources.

Net taxes available for municipal purposes (property taxes) are the primary source of revenue available to the City to pay for municipal services. Total tax revenues in 2018 were \$2,076.3 million, with \$480.5 million collected on behalf of the Province for education school tax and \$3.8 million for business improvement areas. Net taxes for municipal services are collected annually to support operations, with certain amounts directed towards specific programs such as neighbourhood renewal, community revitalization and LRT construction. The remaining tax revenues are applied generally across all departments. Note 17 to the financial statements provides further detail with respect to tax revenue.

User fees and sales decreased from the prior year due to lower utility rate revenue resulting from the transfer of the Drainage Utility to EPCOR. In 2017 the City had eight months of Drainage Utility operations before being transferred on September 1, 2017. This was partially offset with higher revenue earned by the Edmonton Economic Development Corporation as a result of assuming operations of the EXPO Centre on January 1, 2018, and higher land sales.

Investment earnings were less than in 2017 because, as with the variance from budgets, equity markets around the world experienced a decline in 2018.

CAPITAL REVENUES

Capital revenues comprise government transfers, contributed tangible capital assets, developer and customer contributions and local improvement revenues. These revenue sources are approved by City Council as funding sources for capital projects through the capital budget process.

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Capital Revenues

(millions of \$)

	2018 Budget (A)	2018 Actual (B)	Variance (B-A)	2017 Actual (C)	Variance (B-C)
Government transfers - capital	\$ 716.5	\$ 699.3	\$ (17.2)	\$ 412.6	\$ 286.7
Contributed tangible capital assets	101.0	203.9	102.9	217.2	(13.3)
Developer and customer contributions - capital	90.4	26.7	(63.7)	40.9	(14.2)
Local improvements	12.7	11.9	(0.8)	16.3	(4.4)
Capital Revenues	\$ 920.6	\$ 941.8	\$ 21.2	\$ 687.0	\$ 254.8

Comparison to Budget

Capital revenues of \$941.8 million were \$21.2 million higher than budget during the year due to greater than anticipated contributed tangible capital assets of \$102.9 million, which were partially offset by \$81.7 million fewer than expected capital developer and customer contributions, government transfers, and local improvements.

Government transfers - capital were lower than budget by \$17.2 million due to the timing of capital projects, particularly bus purchases, and certain building rehabilitation projects. This was partially offset by \$82.7 million in P3 Canada Fund capital grant revenues recognized related to eligible expenditures incurred for the Valley Line LRT Southeast project since project inception.

Contributed tangible capital assets were greater than budget by \$102.9 million as a result of the transfer of the EXPO Center, Northlands Coliseum and Northlands Park to the City during the year. In 2017, City Council approved a Staged Surrender Agreement transferring ownership of these assets to the City in 2018 in forgiveness of the outstanding EXPO Center loan. Upon transferring the Northlands assets, the City recognized the assets at their estimated fair market value of \$129.9 million. A total of \$47.4 million representing the balance of the advances secured by Tangible capital assets was transferred to tangible capital assets, with the remaining \$82.5 million recognized as Contributed tangible capital assets.

Developer and customer contributions were lower than budget largely due to the timing of capital expenditures.

Comparison to Prior Year

Capital revenues increased from the prior year by \$254.8 million due to an increase in government transfers of \$286.7 million that was partially offset by a decrease in contributed tangible capital assets and developer and customer contributions of \$13.3 million and \$14.2 million, respectively.

2018 Financial Statement Discussion and Analysis

Government transfers - capital increased over prior year due to advancement on key projects funded through government grants in 2018, including the Valley Line LRT Southeast and Bus Renewal and Replacement.

Contributed tangible capital assets decreased from prior year as a result of the transfer of Drainage Utility to EPCOR and reduced development activity, resulting in fewer developer contributed infrastructure assets such as roads and sidewalks. Effective September 1, 2017 drainage assets are contributed by developers to EPCOR. The decrease was partially offset by an increase in contributed tangible capital assets as a result of the transfer of the EXPO Center, Northlands Coliseum and Northlands Park to the City during the year as discussed above.

Capital developer and customer contributions were lower than the prior year due to the transfer of Drainage Utility to EPCOR effective September 1, 2017.

OPERATING EXPENSES

Operating Expenses by Function

(millions of \$)

	2018 Budget (A)	2018 Actual (B)	Variance (A-B)	2017 Actual (C)	Variance (B-C)
Transportation services	\$ 896.8	\$ 904.6	\$ (7.8)	\$ 868.0	\$ 36.6
Protective services	711.0	702.2	8.8	673.6	28.6
Community services	714.0	684.2	29.8	611.0	73.2
Waste Management Utility	207.6	203.7	3.9	211.7	(8.0)
Drainage Utility				117.5	(117.5)
Land Enterprise	70.6	27.6	43.0	11.6	16.0
Fleet Services	36.4	40.9	(4.5)	30.4	10.5
Corporate administration, general municipal and other	423.0	466.2	(43.2)	432.3	33.9
Operating Expenses	\$ 3,059.4	\$ 3,029.4	\$ 30.0	\$ 2,956.1	\$ 73.3

Comparison to Budget

Operating expenses of \$3,029.4 million varied from budget by \$30.0 million, or 1.0 per cent of the consolidated expenses budget.

Community services expenses were under budget in 2018 by \$29.8 million, or 4.2 per cent of the allocated budget. This was primarily due to lower Revolving Industrial Servicing Fund rebate payouts of \$23.0 million, lower than anticipated grant payments related to the Affordable Housing program of \$7.4 million, and a delay in land contributions to the Community Development Corporation of \$5.9 million. Rebate payouts were lower than budgeted through the industrial servicing rebate program due to slower than expected progress by external developers on some industrial developments. Grant payments were less than anticipated under the Affordable Housing grant program due to delays in grant applications. These favourable variances are partially offset with

2018 Financial Statement Discussion and Analysis

higher expenses incurred by the Edmonton Economic Development Corporation as a result of assuming operations of the EXPO Centre on January 1, 2018.

Land Enterprise experienced lower than budgeted costs for land sales due to the timing of sales as a result of market conditions and project delays.

Corporate administration, general municipal and other were greater than anticipated due to higher amortization as a result of the completion of a number of significant capital projects over the last two years.

Comparison to Prior Year

In 2018, operating expenses increased by \$73.3 million over the prior year. All areas had increases related to personnel costs consistent with contractual rate adjustments, partially offset with lower year over year costs resulting from the transfer of drainage services operations to EPCOR on September 1, 2017. In addition to these changes from 2017, expense fluctuations occurred from the prior year for the following reasons by function.

Transportation Services costs increased in 2018 due to various factors, including higher amortization costs due to additional bridge and roadway assets coming into service, and higher snow and ice control costs as a result of an increase in the number and severity of snow events in 2018.

Protective Services costs increased over prior year due to personnel costs to support the City's annexation of Leduc County and a new contract for the Edmonton Police Association, and additional costs related to legalization of cannabis.

Community Services had increased expenses in 2018 due to the Edmonton Economic Development Corporation assuming operations of the Expo Centre on January 1, 2018, and as a result of funding provided to EPCOR through the Sanitary Servicing Strategy Fund for construction of sanitary sewer infrastructure. Since the Drainage Utility transfer to EPCOR on September 1, 2017, the funding provided to EPCOR is reflected as an external expense. Prior to the transfer, the sanitary sewer infrastructure was constructed by the City Drainage Utility and funded internally through the Sanitary Servicing Strategy Fund.

Corporate administration, general municipal and other cost increases were the result of additional personnel costs and an increase in amortization due to additional assets coming into service over the last two years.

2018 Financial Statement Discussion and Analysis

Operating Expenses by Object

(millions of \$)

	2018 Actual (A)	2017 Actual (B)	Variance (A-B)
Salaries, wages and benefits	\$ 1,614.1	\$ 1,577.0	\$ 37.1
Materials, goods and utilities	303.5	282.1	21.4
Contracted and general services	309.8	283.4	26.4
Interest and bank charges	131.2	145.5	(14.3)
Grants and other	117.2	93.0	24.2
Amortization of tangible capital assets	533.7	556.2	(22.5)
Loss(gain) on disposal/transfer of tangible capital assets	19.9	18.9	1.0
Operating Expenses	\$ 3,029.4	\$ 2,956.1	\$ 73.3

In terms of operating expense variances by type, the \$73.3 million increase from the prior year was mainly related to net increases in personnel costs of \$37.1 million, contracted and general services of \$26.4 million, grants and other of \$24.2 million, and materials, goods and utilities of \$21.4 million. This variance was partially offset with lower amortization of \$22.5 million. The remainder of the increase from prior year is attributable to interest and bank charges, and loss on disposal/transfer of tangible capital assets.

Salaries, wages and benefits increases over prior year are consistent with contractual rate adjustments, partially offset by lower personnel costs as a result of the transfer of the Drainage Utility to EPCOR in 2017.

Contracted and general services increased mainly as a result of expenses incurred by the Edmonton Economic Development Corporation as a result of assuming operations of the EXPO Centre on January 1, 2018 and higher snow and ice control costs due to an increase in the number and severity of snow events in 2018.

Grants and other costs increased in 2018 primarily due to an increase in funding provided to EPCOR through the Sanitary Servicing Strategy Fund for construction of sanitary sewer infrastructure as discussed previously under Community Services.

Materials, goods and utilities increased mainly due to higher land sales costs as more land sales occurred in 2018, higher fuel costs largely as a result of an increase in fuel prices, and higher snow and ice control costs due to an increase in the number and severity of snow events in 2018.

Amortization of tangible capital assets for the entire City decreased in comparison to prior year mainly as a result of the transfer of Drainage Utility assets to EPCOR in 2017, and an impairment of the Edmonton Compost Facility recorded as amortization in 2017. This is partially offset by additional bridge and roadway assets coming into service in 2018 related to work on arterial roadways and the Neighbourhood Renewal Program.

2018 Financial Statement Discussion and Analysis

Schedule 2 – Consolidated Schedule of Segment Disclosures, provides an analysis of revenues and expenses (by object) for each of the significant business groupings within the reporting entity. A description of each of the segments is provided in Note 28 to the financial statements.

FINANCIAL CONTROL AND ACCOUNTABILITY

The City maintains the following processes to ensure that appropriate financial control and accountability are maintained and a proactive approach is taken to identify and address financial challenges.

FISCAL POLICIES

The City's financial governance policies and practices ensure Edmonton's continued sound fiscal management and long-term financial sustainability. These policies and practices are continuously assessed using leading practice and research on several policy and strategy topics. The City has drafted White papers to provide a foundation for discussing the key financial issues and questions related to debt, franchise fees, investments, user fees and property assessment and taxation. Some of the more significant policies are discussed below.

The City has policies in place for various reserves, including the Financial Stabilization Reserve, that ensure sufficient funds are in place to satisfy the financial needs of the operations being supported by the reserve.

City Policy C579B, Traffic Safety and Automated Enforcement Reserve, was established to address the revenue variability associated with automated traffic enforcement. This reserve also accumulates annual traffic safety program surpluses and funds an annual traffic safety program deficit when necessary. Annual automated enforcement revenue funds ongoing traffic safety initiatives and other programs approved by City Council through the budget process. The reserve helps manage this process and supports transparency related to the use of automated enforcement revenues to fund City operations.

On June 26, 2018, City Council approved City Policy C604, Edmonton Police Services (EPS) Funding Formula. The policy established guidelines and the approach for the planning and approval of the multi-year funding formula for the EPS. This funding formula will provide funding certainty to allow for long-term budgeting and workforce planning for EPS and other tax-supported operations. It allows the City to sustainably allocate budget funds based on predictable indicators that reflect police cost inflation and changes in demand. To this end, City Council also approved the establishment of an EPS Reserve fund to allow for the management of police operational surpluses and deficits over the long term through City Policy C605, Edmonton Police Services Reserve.

During the year, City Council approved City Policy C610, Fiscal Policy for the Planning and Development Business. This policy formalized the fiscal management and operating principles of the City's planning and development operations to ensure long term fiscal sustainability and service stability while enabling growth within the City of Edmonton. The policy clarified the purpose of the Planning and Development Reserve, which is to be used to stabilize the planning and development business across extended periods of time.

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In 2018, Administration developed a new Land Governance Model to replace the previous Land Management Strategy and strengthen the City's corporate approach to land management. The new model helps ensure land management decisions are made from an integrated perspective that includes input from across the corporation. The new Land Governance Model also provides for on-going monitoring of City land holdings to ensure they are used appropriately to meet the City's needs. The model defines the process and funding related to strategic land acquisitions for future municipal purposes, specifically restricting the use of land enterprise retained earnings to fund strategic land acquisitions for municipal purposes on an interim basis.

The City's Debt Management Fiscal Policy provides guidelines for prudent debt management and ensures that debt is used responsibly to advance key infrastructure projects.

City Council's Waste Management Utility Fiscal policy governs the financial relationship between the City and the municipally owned and operated utility. This policy requires the utility to operate in a manner that balances the best service at the lowest cost while employing private sector approaches to rate setting. The utility is required to charge rates that are sufficient to meet expenditures and cash flow requirements, repay capital debt and ensure financial sustainability.

In April of 2018, City Council approved the Fiscal Policy for the Blatchford Renewable Energy Utility. The Fiscal Policy provides the overarching framework that outlines the financial parameters that will guide the long term financial sustainability of the utility. In December 2018, City Council approved Bylaw 17943, which established the Blatchford Renewable Energy Utility. Bylaw 17943 outlines requirements for properties receiving energy service through the utility and the relevant rates, fees and charges.

EPCOR water and wastewater rates were approved by City Council in 2016 through the related Performance Based Regulation (PBR) Plans which set these rates for the period April 1, 2017 to March 31, 2022. The Drainage Utility was transferred to EPCOR in 2017 at which time the utility's rates for the period January 1, 2018 to March 31, 2022 were approved through the related PBR Plan. The PBR framework and annual PBR progress reports allows for City Council to have oversight and governance over water, wastewater and drainage rates over a longer term and provides incentives to ensure that EPCOR operates more efficiently while providing appropriate service levels.

STRATEGIC PLANNING

The City of Edmonton follows a strategic planning framework that enables a consistent and integrated approach to strategy development, planning and performance evaluation.

After extensive public consultation, Council approved the foundational components of Edmonton's strategic plan 2019-2028 in June 2018. This guiding document outlined four 10-year strategic goals, including the unifying principle of being a connected city, to guide decision making. The document also includes a vision for Edmonton in 2050. Edmonton's plan as set out in this guiding document recognizes the importance of Edmontonians, institutions, community and businesses working together to achieve the City's goals and vision.

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Edmonton's strategic framework will guide the work of Administration through two key plans. First is in the development of The City Plan, which will outline the way the city will build and grow to two million people. Second is the Corporate Business Plan, which outlines the services and projects that Administration will implement to contribute to achieving the goals and vision, as well as ongoing services.

The City Plan is part of a larger story; it is the connection point between Edmonton's strategic plan and the Corporate Business Plan. It will identify how Edmonton actualizes the four goals - Healthy City, Urban Place, Regional Prosperity and Climate Resilience - in our community.

The Corporate Business Plan will align the City's work to the ten-year goals established by City Council and the community. The purpose of the plan is for Edmontonians to clearly see how the City is investing their tax dollars to build a city that meets their needs. The plan will define where projects and initiatives will make an impact by clarifying which work is making transformational impacts on the strategic goals, and which work is improving the overall business and/or services of the City. The Corporate Business Plan will be updated annually to address emerging issues support continuous improvement to help the City achieve the goals developed by the community, and ensure ongoing excellence in service delivery.

Council's strategic plan and the Corporate Business Plan will be presented to Council in early 2019. Enterprise performance management will be used to monitor, evaluate and measure the City's actions and progress towards the strategic goals.

City Council approved City Policy C600, Enterprise Performance Management, on May 8, 2018. This policy establishes the City's approach to enterprise performance management as a systematic process to prioritize, measure, report and improve performance relative to what is important to Council and residents. Monitoring progress enables data-driven decision making and drives continuous improvement. When fully operational, enterprise performance management will support the prioritization of projects and processes, reporting, learning and improvement, and will increase accountability to Edmontonians and Council.

PROGRAM AND SERVICE REVIEW

The purpose of the Program and Service Review is to determine whether municipal services align with the expectations of Council and Edmontonians by examining relevance, effectiveness and efficiency.

The review resulted in budget savings and recommendations for process improvements, many of which have been incorporated into the 2019-2022 Operating and Capital budgets. The Program and Service Review team will continue to identify savings and provide recommendations to ensure the City's financial efficiency and progress toward City Council's goals.

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At the end of 2018, there are completed reviews for 20 of 73 services, and reviews of an additional 25 services are in progress. Administration will continue to conduct reviews that thoughtfully consider the perspectives of diverse stakeholders and the service expected by all Edmontonians.

BUDGETING

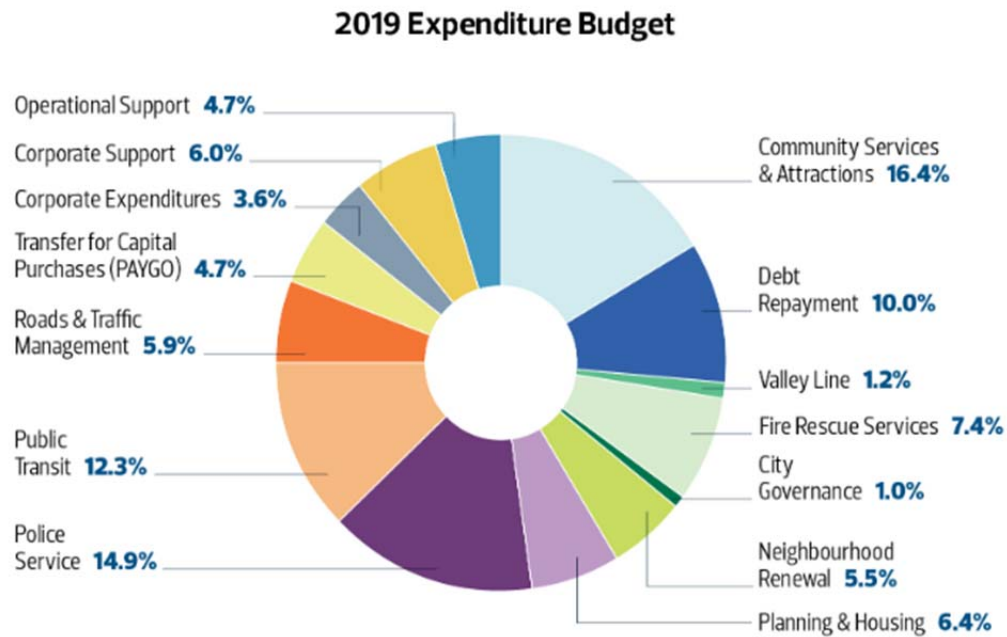
Guided by Edmonton's strategic plan, the 2019-2022 Operating and Capital Budgets assist Council in making strategic decisions about how to allocate City resources. This multi-year approach allows the City to align strategic plans, business plans, and operating and capital budgets, to ensure the dollars are spent to achieve City Council's vision. It also allows for better alignment with Councillor election terms, providing the foundation for more informed and strategic financial decision making. Funding can be reallocated across different years of the budget and needs can be assessed over a longer term to allow for more prudent and informed financial decision making, while building stable program and service delivery and infrastructure development.

The multi-year process includes opportunities to adjust the budget twice a year through the supplementary budget adjustment process approved by City Council. During the supplementary budget adjustment process, Council can adjust the capital and operating budgets in response to changing project needs, new funding opportunities, changes in federal and provincial budgets, changes imposed by legislation, Council directed changes in priorities, operating impacts of capital projects, unforeseen impacts to economic forecasts, and emerging issues. On December 14, 2018, City Council approved the 2019-2022 Operating and Capital budgets.

The operating budget identifies how resources for the day-to-day costs required to run the city are allocated, for services such as maintaining roads and public transit, police, bylaws and fire rescue services, as well as parks and waste management.

The approved operating budget includes a 2.6 per cent a year general property tax increase over the next four years. The 2.6 per cent increase in 2019 is made up of a 0.5 per cent increase for all civic operations, 0.6 per cent for Valley Line LRT, 0.3 per cent for alley renewal, and 1.2 per cent for the Edmonton Police Service. The chart below shows the portion of the City's tax-supported budget that is spent on each major expense category:

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The Bylaw to establish the 2019 municipal tax for all property types will be set by City Council in April 2019. Changes to the operating budget that will impact the tax-levy may be completed prior to the taxation bylaw approval.

The capital budget strikes a balance between investments in infrastructure growth and the requirement to maintain and renew existing City assets. It determines the investment in Edmonton’s hard infrastructure, including the construction of buildings such as recreation centers and libraries, and transportation assets including LRT lines and bridges. The foundation of the 2019-2022 Capital Budget is the 2019-2028 Capital Investment Outlook, a high level overview of the City’s capital investment requirements over the next ten years that supports the strategic direction of Council.

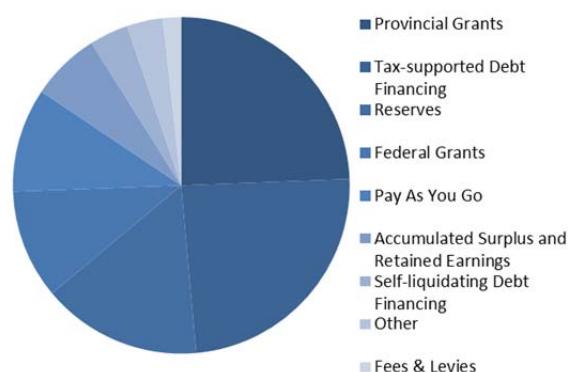
The four-year capital budget will see investment of \$5.0 billion on infrastructure based on the approved capital budget. The funding and financing sources are as follows:

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2019-2022 Capital Budget - Funding Sources

(millions of \$)

Provincial Grants	\$ 1,224.4
Tax-supported Debt Financing	1,214.6
Reserves	769.1
Federal Grants	526.6
Pay As You Go	502.2
Accumulated Surplus and Retained Earnings	333.7
Self-liquidating Debt Financing	187.3
Other	174.2
Fees & Levies	87.7
<hr/>	
Grand Total	\$ 5,019.8



ACCOUNTING AND FINANCIAL REPORTING

The City of Edmonton is organized into various business areas that are responsible for managing the delivery of program services in accordance with the resources allocated to those programs. The City currently uses a shared services model for financial services; all business areas reporting to the City Manager share a common accounting and reporting system, and financial and accounting services are administered within financial services and delivered to each business area based on their needs. Accounting and financial reporting functions are centralized to improve the quality and timeliness of financial reporting and increase accounting oversight and transactional consistency to support better financial decision-making.

The City of Edmonton Library Board, the Edmonton Police Service, Waste RE-solutions Edmonton and Edmonton Combative Sports Commission use the same accounting system as the City but report through their own boards or commissions. EPCOR, Edmonton Economic Development Corporation, Non-Profit Housing Corporation and Fort Edmonton Management Company each have independent accounting systems and report through their respective boards.

Administration reviews operating financial update reports on a monthly basis for areas that report to the City Manager. This process includes comparing year-to-date and year-end projected results relative to corresponding budgets and reporting on significant City reserves. Quarterly operating reporting includes debt and economic updates that are reviewed by Administration and provided to City Council along with recommendations to address opportunities and challenges. City Council reviews capital reporting for second, third and fourth quarters, which includes reporting on major projects in comparison to originally approved budgets and timelines. Both operating and capital performance reports are used to help guide budget strategies.

The operating budget is also presented in a format consistent with audited annual financial statements that are amended for adjustments required to adhere to PSAS. The objective is to provide City Council and other users of

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the financial statements and budget documents an improved understanding of the budget approved by City Council compared to the actual results reported in the audited financial statements.

The City continues its commitment to compliance with public sector accounting standards as established by the PSAS board. Details of future accounting standards and pronouncements are included in Note 1 to the financial statement.

RECOGNITION FOR ACHIEVEMENT

Award programs in the financial sector area continue to recognize the City of Edmonton for a high standard of achievement.

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Canadian Award for Financial Reporting to the City of Edmonton for its annual financial report for the fiscal year-ended December 31, 2017. The Canadian Award for Financial Reporting program was established to encourage Canadian municipal governments to publish high quality financial reports and to provide peer recognition and technical guidance for officials preparing these reports. To receive a Canadian Award for Financial Reporting, a government unit must publish an easily readable and efficiently organized annual financial report that conforms to program standards. Such reports should go beyond the minimum requirements of public sector accounting standards and demonstrate an effort to clearly communicate the municipal government's financial picture, enhance an understanding of financial reporting by municipal governments and address user needs. A Canadian Award for Financial Reporting is valid for a period of one year and, in 2017, Edmonton received this award for the 25th consecutive year.

The GFOA established the Popular Annual Financial Reporting Awards Program to recognize local governments that produce high quality summarized annual financial reports. The reports must be readily accessible and easily understandable to the general public and other interested parties without a background in public finance. The City received the Popular Annual Financial Reporting Award for the fifth consecutive year for their 2017 Financial Report to Citizens.

The City also received the GFOA award for Distinguished Budget Presentation for the 2016-2018 fiscal years beginning January 1, 2016 and ending December 31, 2018. To be eligible for this award, a governmental unit must publish a budget document of the highest quality that meets program criteria as a policy document, as an operations guide, as a financial plan, and as a communications device.

AUDITING PROCESS

The MGA requires municipal councils to appoint an independent auditor. In 2015, a tender for audit services was completed and City Council appointed the firm of KPMG LLP, Chartered Professional Accountants, as External Auditor for a five-year term. The auditor must report to City Council on the annual consolidated

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financial statements. KPMG also audits the Provincial Financial Information Return and each pension and benefit plan administered by the City. Certain government transfer programs also require external audit.

The City's Audit Committee serves as a Committee of Council to assist in fulfilling its oversight responsibilities. Audit Committee provides oversight and consideration of audit matters brought forward by the City Auditor and the External Auditor. The Committee includes the Mayor, four Councillors and two public members as outlined under Bylaw 16097, Audit Committee Bylaw. Audit Committee reviews the consolidated financial statements and makes a recommendation to City Council for the approval of the City's financial statements.

The City has an internal audit function independent of the City Administration. The Office of the City Auditor reports directly to City Council through Audit Committee, empowered by Bylaw 12424, City Auditor. This bylaw establishes the position of City Auditor and delegates powers, duties, and functions to this position. The City Auditor has two roles:

Agent of Change – to conduct proactive and forward looking projects based on the provision of strategic, risk and control-related consulting services to better serve the changing needs of the corporation and bring about improvement in program performance; and

Guardian – to conduct projects directed primarily towards providing assurance through review of existing operations, typically focusing on compliance, efficiency, effectiveness, economy and controls.

LONG-TERM SUSTAINABILITY

The City is committed to an integrated approach to risk management and establishing effective relationships with other orders of governments, which are a critical component of the City's long term sustainability.

City Council approved an Enterprise Risk Management Policy in March 2016 to ensure that enterprise risks are proactively identified, evaluated, communicated and managed on an ongoing basis. Guided by this policy, the Enterprise Risk Management process continues to evolve as the City progresses toward becoming a risk-mature organization.

In November 2018, Audit Committee was presented with the 2018-2019 Corporate Strategic Risk Register. This document identified the City's top 10 risks to achieving the City's strategic goals, with the greatest risks being economic swings and uncertainty regarding funding from other orders of government, both of which are discussed further below. The current process, consistent with the requirements of the Enterprise Risk Management Policy, is to update the register on a regular basis and present it to the Audit Committee for analysis and discussion. The City continually monitors global, national, and local political, economic, social, and technological developments and trends, to plan for future risks and opportunities. These risks are considered and factored into the risk register, business plans, and operating and capital budgets, in an effort to ensure the City is able to provide services and infrastructure to its growing population in a sustainable manner.

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ECONOMIC RISKS

Edmonton's population and economy is expected to continue growing, increasing the demand for new services and the pressure on existing services. The City has limited revenue generation tools and Alberta's economy has historically been dominated by a single, volatile industry. In addition, considerable global political uncertainty and rising interest rates are contributing to slowing global economic expansion and economic uncertainty. This means that the next four years present uncertainty and the City should be prepared for potential negative shocks to its economy. The City's business plans and operating and capital budgets aim to balance these economic realities with the need to provide quality services and infrastructure to a growing population.

The City faces challenges in funding new demand for services and infrastructure in light of current economic conditions and an inelastic primary revenue source in the form of property taxes. Property taxes fund close to 60 per cent of the City's annual operating costs, including portions dedicated to capital projects. However, they lag in reacting to increased service and infrastructure demand. This inelasticity emphasizes the need for long-term planning, risk management and diversification of City revenues. The City is addressing the infrastructure and service funding gap using various strategies and revenue stream diversification, including securing more stable and predictable provincial government funding, which is discussed further below.

The 2019-2022 Operating and Capital Budgets, and 2019-2028 Operating and Capital Investment Outlooks outline the City's operating and capital spending taking into consideration these economic challenges. The long-term sustainability of City infrastructure is impacted by the City's capital renewal plan. When the City discusses the concept of renewal, this refers to investment in existing infrastructure to restore it to an efficient operational condition and extend its service life. Investing in renewal at key points throughout the life of an asset maintains its condition at a higher level while extending the life of the asset. The result of good renewal investment is reduced long-term requirement for capital funding while maintaining a suitable level of service for residents.

The City manages a broad range of infrastructure assets. As of 2017, 49 per cent of City assets are in very good/good condition, 41 per cent are in fair condition, and 10 per cent are in poor or very poor condition. This represents a 7.7 per cent reduction of assets in poor condition since 2011. The City uses a customized assessment methodology — the Risk-based Infrastructure Management System (RIMS) — which was developed by the City in 2011. Over the last decade, RIMS has evolved into a dynamic analytical tool designed to predict the optimal funding for the renewal of existing infrastructure.

INTERGOVERNMENTAL

As Edmonton continues to grow and diversify, so does the scale and complexity of the services it provides. Edmonton requires appropriate legislation, programs and policies that will enable the City to govern effectively and efficiently, respond to local needs, and enhance the quality of life for residents. Edmonton can achieve this in part by building and leveraging relationships with other orders of government, other municipalities, and municipal organizations.

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The City of Edmonton exists in an environment of ever-present financial uncertainty around the security and stability of provincial and federal grants. The City's infrastructure program is highly dependent on grant funding. The City is working closely with the Province on the City Charters, which will provide Edmonton with more stable revenue sources that will enable the City to better plan and construct major infrastructure projects.

Since 2014, the Government of Alberta has worked with Edmonton and Calgary to develop City Charters that recognize the unique challenges and opportunities Alberta's two largest cities face every day. The two cities have evolved into complex corporations responsible for billions of dollars in services, infrastructure and operations. The charters will provide Edmonton and Calgary with more authority and flexibility related to funding and other governing policies to help address risks and sustainability challenges faced by the two cities.

The *City Charters Fiscal Framework Act* (Framework) received royal assent on December 11, 2018. The fiscal framework provides baseline infrastructure funding for Edmonton and Calgary that is tied to the Province of Alberta's future revenue growth. The fiscal framework will replace the cities' *Municipal Sustainability Initiative* (MSI) funding when that program is complete in 2022. The Framework introduces a revenue-sharing component that increases the funding cities will receive as provincial revenue and fuel sales grow. This funding formula provides a predictable level of funding that will help cities plan and construct major infrastructure projects. Additional components of the framework will see dedicated funding for long-term transit in the two cities and a new fund for significant regional infrastructure projects in the two cities' metropolitan regions.

The *City of Edmonton Charter 2018 Regulation* (Regulation) was formally approved by the Government of Alberta on April 4, 2018. The Regulation contains policy tools that could provide the City with increased authority or flexibility in areas such as administrative governance, assessment and taxation, city planning and environment. City Council, with input from residents and businesses, can decide which of the Charter policy tools are most appropriate for Edmonton. This is a public process that will require significant analysis, public and stakeholder engagement, policy changes, and bylaw amendments.

Another important aspect of the Charters that was unveiled in 2017 is a historic collaboration agreement. This agreement commits the Province and its two largest cities to collaboration on the development of solutions for complex and emerging issues. Formal collaboration tables made up of senior provincial and City administration meet on a regular basis to work on emerging issues of mutual concern.

Administration expects that all the elements of the City Charters will be completed and in place by early 2019.

A new, modernized MGA is now in place for Edmonton and other municipalities across the province. The MGA is the second-largest piece of legislation in Alberta and helps define how Alberta municipalities are governed, funded and developed. The City of Edmonton has been an active participant in the Government of Alberta's MGA review process since 2012. On October 26, 2017 the Government of Alberta proclaimed the majority of the amendments to the MGA. The rest of the amendments came into force in phases over 2018. The modernized MGA takes into account how important it is for Edmonton and regional municipalities to collaborate on issues of

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shared importance such as land use, infrastructure, and funding of regional services. Edmonton now has more input into decisions that affect growth and development and provide long-term benefits to residents and the region.

City Administration is currently working on the implementation of the new provisions resulting from the MGA Review and the *City of Edmonton Charter, 2018 Regulation* as guided by Council's priorities.

The City Charters and modernized MGA helps ensure that the long-term sustainability needs of the City of Edmonton are met and will support efficient local governance.

OTHER RISKS

The City also manages risk to help ensure its long-term sustainability and achievement of Council's strategic goals and outcomes through various other strategies, including but not limited to the following.

- Environmental risks are monitored through internal City practices and policies, which aid in the effective management of environmental risks and responsibilities. City Council approved Edmonton's Environmental Management System Policy as well as an Environmental Policy. The policies ensure commitment to sound environmental management practices, and stewardship in all aspects of its corporate activities. Standard environmental management system practices across the City will address environmental regulatory compliance, pollution prevention and continual improvement
- The corporate Property and Casualty Risk Management area provides risk management advice, claims adjusting, purchase of insurance and risk control inspections.
- Ongoing proactive analysis of the physical, contractual and insurance risks associated with capital projects or major initiatives and establishment of appropriate measures to identify and control project risk. For example, Valley Line LRT Southeast, from Mill Woods to Downtown, is being developed with the construction, operation and maintenance provided through a P3 delivery method, which shares risks between the City and its private partners. In 2017, City Council approved City Policy C591, Capital Project Governance Policy, which sets out to ensure that an appropriate level of development is completed on projects prior to them moving onto the delivery phase. This rigorous risk management process helps to ensure that key projects are completed safely, on time, on budget, on quality, and in scope.
- Hedges are purchased for future fuel purchases when deemed beneficial in order to stabilize operating budgets in the face of fuel price fluctuations. Similarly, forward currency contracts are used to mitigate foreign exchange risk within the City's foreign equity investments and capital purchases.
- Borrowing is completed through the Alberta Capital Finance Authority, which allows Alberta municipalities to borrow at interest rates which would not be available to municipalities acting independently. The interest rates are set for the term of the borrowing, therefore reducing risk associated with interest rate fluctuations.
- The City has a Financial Stabilization Reserve that may be used to address emergent needs without impacting the City's financial position in the long-term. A financial risk based review was completed for the City in 2018, identifying potential risks faced by the City and the probable financial cost of each risk.

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The review substantiated the minimum and target balances of the reserve established through City policy.

- The City's Debt Management Fiscal Policy provides for prudent management of debt and ensures debt is used responsibly without burdening the financial health and long-term sustainability of the City. Administration continues to monitor the use of debt and provide debt forecasts as part of ongoing reporting to City Council.
- The City continues to leverage data analytics in order to discover and communicate meaningful patterns in data, which help to predict and improve business and financial performance, recommend strategies, and guide financial decision-making.

CONCLUSION

Throughout 2018, the City of Edmonton has maintained its financial health and the City's economic performance remains one of the best in the province.

For the seventh consecutive year, Standard & Poor's has given the City of Edmonton a rating of AA+. This rating is the second-highest possible, and reflects the City's strong financial and economic fundamentals. In August 2018, Standard & Poor's revised their yearly outlook rating of the City of Edmonton downward from stable to negative and kept the outlook at negative for 2018. The outlook reflects Edmonton's increasing debt burden, lower than anticipated budgetary performance, and potential downgrade in future ratings depending on the magnitude, timing and funding of additional capital projects, including Stage two of the Valley Line LRT. However, the outlook also indicated that the City has an exceptional liquidity position, strong financial management and low contingent liabilities. The rating considered the management team to be experienced and qualified to effectively enact appropriate fiscal policies and respond to external risks.

Recent economic uncertainty has reinforced the need to maintain flexibility and to monitor both the economy and the City's financial condition in order to be able to react and adapt to economic impacts. The City will continue to be challenged to manage emerging competing financial needs as the major centre for the region, and to maintain existing services while addressing service and infrastructure needs associated with the growth. The recently approved 2019-2022 Operating and Capital budgets and business plans have helped the City position itself well for the future.

Robust financial policies, strategies, guiding principles and a healthy financial position ensure the continued sound fiscal management and long-term financial sustainability for the City of Edmonton.

Stacey Padbury, CPA, CA
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Financial and Corporate Services
April 16, 2019