HALIFAX

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Item No. 5
Committee of The Whole
November 27, 2018

TO: Mayor Savage and Members of Halifax Regional Council

SUBMITTED BY: Original Signed by
Jacques Dubé, Chief Administrative Officer

DATE: November 20, 2018

SUBJECT: Fiscal Framework

ORIGIN

The fiscal direction from Council for the 2019-20 and 2020-21 Budget and Business Plans needs to be established.

LEGISLATIVE AUTHORITY

Halifax Charter, section 35 (1) The Chief Administrative Officer shall (B) ensure that an annual budget is prepared and submitted to the Council.

RECOMMENDATION

It is recommended that Halifax Regional Council direct staff to develop the 2019-2020 Budget and 2020-21 Budget in Principle according to Council's approved priorities, and preliminary fiscal direction, including:

- maintaining the appropriate level of existing services with the addition of the new services previously approved by Council;
- a three-year capital budget that recapitalizes assets, funds growth related issues and is balanced to the fiscal framework;
- a responsible debt position;
- appropriate reserve balances that allow for risk mitigation, future obligations, and opportunities; and,
- alignment of the current average tax bill for residential homes and commercial properties under two scenarios:
  a) 2.1% increase for 2019-20;
  b) 2.9% increase for 2019-20.

BACKGROUND

In 2017-18 Council initiated its first two-year budget cycle. That cycle ended with the 2018-19 Budget. Consequently, 2019-20 is the start of the next two-year budget cycle. The first year (2019-2020) will be the formally approved budget. The second year (2020-2021) will be approved in principle and used throughout 2019-2020 as a planning document. Staff is also preparing longer term fiscal direction for Year 3 (2021-2022) and Year 4 (2022-2023).

As part of that process, Council has already started a dialogue on priorities and outcomes. The Three-Year Capital Budget will be presented to Council on December 4, 2018. Commencing January 16, 2019 and continuing through into February of 2017, Council will begin the review of individual budgets and plans for the upcoming fiscal year. The first stage of this process, however, consists of providing broad direction to staff on the underlying assumptions for taxation and fiscal items. These assumptions, in turn, will influence the available funds for each of the services and projects the municipality is able to undertake in 2019-20 and future years.

DISCUSSION

Preparing and finalizing a budget for Halifax is an extensive exercise which includes many iterative steps. There is tremendous demand for new and improved services; the maintenance of existing services; extension of current services to new homes and businesses; and, the ongoing maintenance of $3.6 billion in municipal assets. Balanced against this is the need to set appropriate tax levies on homeowners, businesses, and others. The revenues from these rates allow for the provision of these services. Regardless, the proposed tax levy must be balanced against the value to society of those services, the ability of taxpayers to pay for those items, and the broad competitiveness that the mix of services and taxes will support.

Four Critical Influences and Seven Key Council Decisions:

As directed by Council, staff are preparing for a longer term fiscal approach that integrates key items in the budget process. As such, Staff have identified four critical influences that affect the municipality's fiscal situation. These four key influences are:

1. Operating Budget,
2. Net Capital Budget,
3. Tax Supported Debt, and,
4. Reserves (Net Obligations)

Within these four critical influences there are seven key decisions that Council will have to provide direction on to staff:

Operating Budget

1. Taxes – Should taxes rise, fall or stay the same?
2. Services (Existing) – How can value be optimized?
3. Services (New) – Will new services be funded?

Capital Budget

4. How much should be invested in State of Good Repair, Growth and Service Improvements?
5. Capital from Operating – How much should HRM pay down on the Capital Budget?

Tax Supported Debt

6. What level of debt does HRM wish to approve?

Reserves

7. What reserve balances does HRM expect?

Economic and Financial Assumptions

The HRM economy is a small open economy that shows consistent yet moderate growth. That growth is supported by a mixture of strong public-sector employment and by a considerable presence of finance, insurance, and real estate activity Staff consulted with the Halifax Partnership in determining a series of assumptions for use in fiscal scenarios and has used data from the Conference Board of Canada and Canmac Economics.

HRM's economy is growing, with positive forecasts for Real GDP and income growth of 2.5%. Inflation is stable at 2.1%. The population and number of dwelling units are growing steadily over the next four years.

	Year 1 2019-20	Year 2 2020-21	Year 3 2021-22	Year 4 2022-23
Real Gross Domestic Product (RDP)	19,234	19,518	19,855	20,199
Personal Income per Capita	46,179	47,350	48,661	50,032
- Percent Change	2.5%	2.5%	2.8%	2.8%
Inflation (CPI)	2.1%	2.2%	2.2%	2.2%
Population (000)	444.0	449.0	455.0	460.0
Dwelling Units	197,887	200,199	202,464	204,706
- Percent Change	1.2%	1.2%	1.1%	1.1%

To prepare a base case scenario, staff has made several assumptions related to other factors. They have assumed that the average taxes for residential and commercial taxpayers remain constant, that Tax Supported Debt continues to decline and that Capital from Operating increases as per Council's approach to those targets. Included in the forecast are the cost of wage settlements and higher fuel prices.

The Base Case Scenario

Based on the initial assumptions, staff projected a base case scenario for the next four years. This scenario includes the above economic and financial assumptions as well as the estimated cost of service adjustments already approved by Council. The Base Case scenario shows a $15m shortfall in the first year, which without corrective actions, widens to $48m by year 4. The growth in tax revenues is considerably less than the expected cost of services. The key factors in the forecast are:

- **New or adjusted services (additional RCMP, Ferry service, cost of operating new assets) will cost $7.9m**. Many of these services are provided to deal with the growing population across the region;

- There is **considerable wage pressure, resulting in an increase of $15m** attributed to collective agreements, step positions, an additional 2 work days in the year as well as reclasses and other adjustments. (For clarity, there is another $2.6m in compensation that is part of the $7.9m in new services);

- **Fuel prices have increased significantly since the 2018-19 budget** was established, adding $3m in cost to operate vehicles such as police cars, fire engines, and transit buses, as well as heating municipal facilities.

- While the economy is strong, the **commercial assessment values are at the low point of their cycle and are growing only modestly.** Hence, property tax revenues from new growth are minimal, providing only $3m.

Options

There are a limited number of scenarios that would balance the provision of services with the property taxes and fees paid by the public.

One approach is to reduce municipal services, and hence their costs in the operating budget. There is considerable cost pressure on existing budgets. These pressures come from inflation, the increasing number of homes to service and the addition of new or expanded services. While efficiencies, cost improvements and re-prioritizations are to be expected, they are unlikely to offset the rising cost pressures in many services.

Cost pressures on existing services in 2019-20 average 3.3%. The greatest cost pressure is on salaries and fuel. Both are influenced by the underlying economics of inflation and rising incomes. Other cost pressures are currently minimal or have been absorbed across the organization. Savings have occurred in debt charges ($3m). Staff have also identified individual savings across the organization as well as areas where revenue forecasts can be adjusted upward.

However, the Municipality is heavily dependent upon property tax revenues to finance its operations. Property tax (along with Payments in Lieu and area rates) funds almost 80% of operations. If costs continue to rise and assessment is flat the municipal budget cannot be sustained while average taxes remain flat. Under these circumstances, the only options for the municipality are to either reduce services or increase taxes. Unless services are constrained, tax increases that are consistent with the rates of inflation and income growth are inevitable.

Rather than holding the average tax bill flat (essentially a reduction in real terms), taxes should rise by 2.9% and 2.2% in years 1 and 2 of the Plan. This is $56 on the average single-family home in 2019-2020 and $44 in Year Two. These changes are slightly higher than inflation and but comparable to personal income growth. In years 3 and 4 increases would be consistent with inflation and would provide for a more sustainable financial path. In themselves, these rate changes would not allow for additional service expansion above that already approved by Regional Council.

FINANCIAL IMPLICATIONS

There are no immediate financial implications associated with this recommendation.

RISK CONSIDERATION

Risks related to the recommendations in this Report include changes in the underlying economic assumptions as well as assumptions as to the value of the final assessment roll. The risks can be better defined and managed as the two-year budget is developed. Similar risks will also be present in most of the alternatives to the recommendations.

COMMUNITY ENGAGEMENT

A Citizen Survey has been conducted to gauge citizen attitudes towards services and taxes. Budget Consultations will include an opportunity for the Public to attend the Business Unit draft budget presentations to Committee of the Whole, and ask questions afterwards.

ENVIRONMENTAL IMPLICATIONS

None

ALTERNATIVES

None

ATTACHMENTS

1. Presentation - Fiscal Framework 2019 to 2023

A copy of this report can be obtained online at halifax.ca or by contacting the Office of the Municipal Clerk at 902.490.4210.

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Attachment 1

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Fiscal Framework 2019 to 2023

The Challenges of Growth

Committee of the Whole
November 27, 2018

Outline

- Introduction
- Economic Assumptions
- The Multi-year Budget
  - Operating
  - Debt
  - Capital
  - Reserves
- Summary
- Recommendations

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Introduction

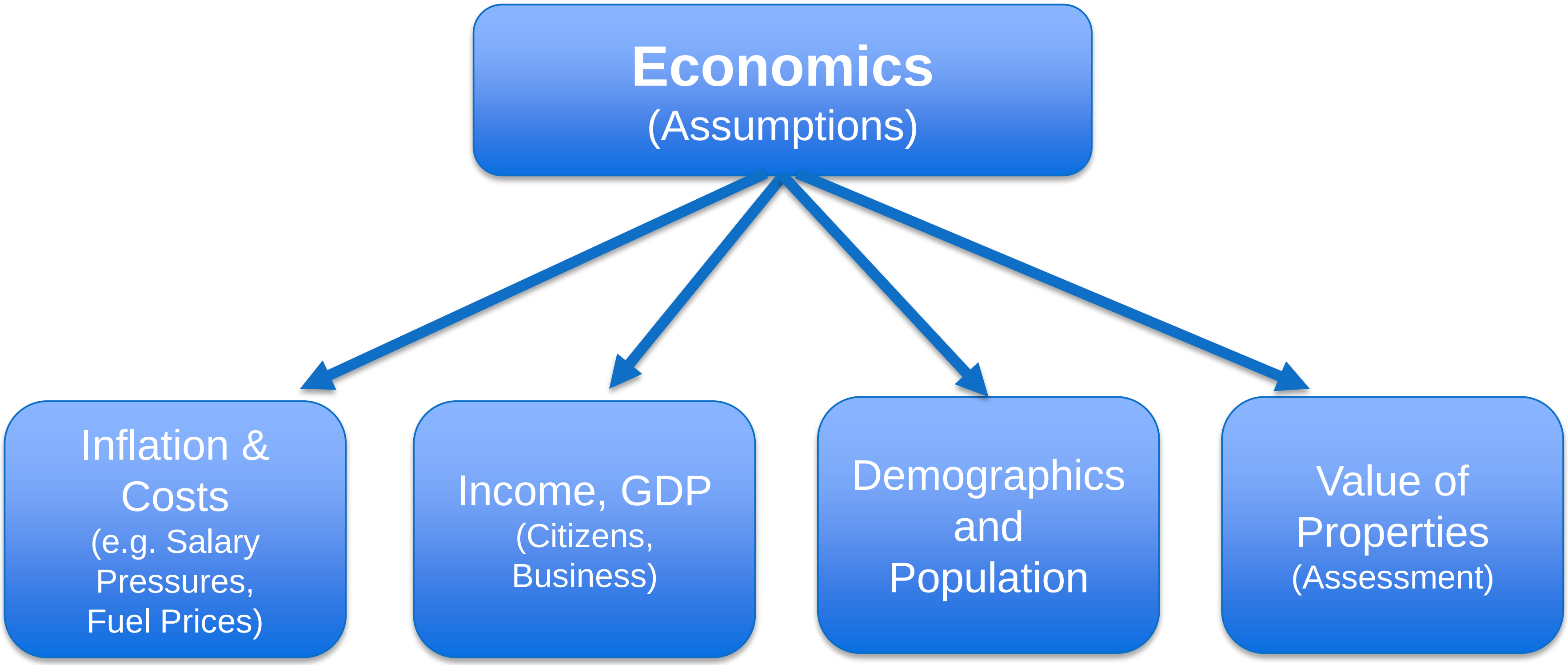
- **HRM's Second Two Year Budget**
  - Predictability/sustainability
  - Enables long term view
  - Helps Council plan better

- **Approach**
  - Year 1 (2019-20) is formal budget
  - Year 2 (2020-21) to budget quality
  - Years 3 and 4 are estimates

- **Decisions remain with Council**

ECONOMIC ASSUMPTIONS

Influences Outside Council's Control

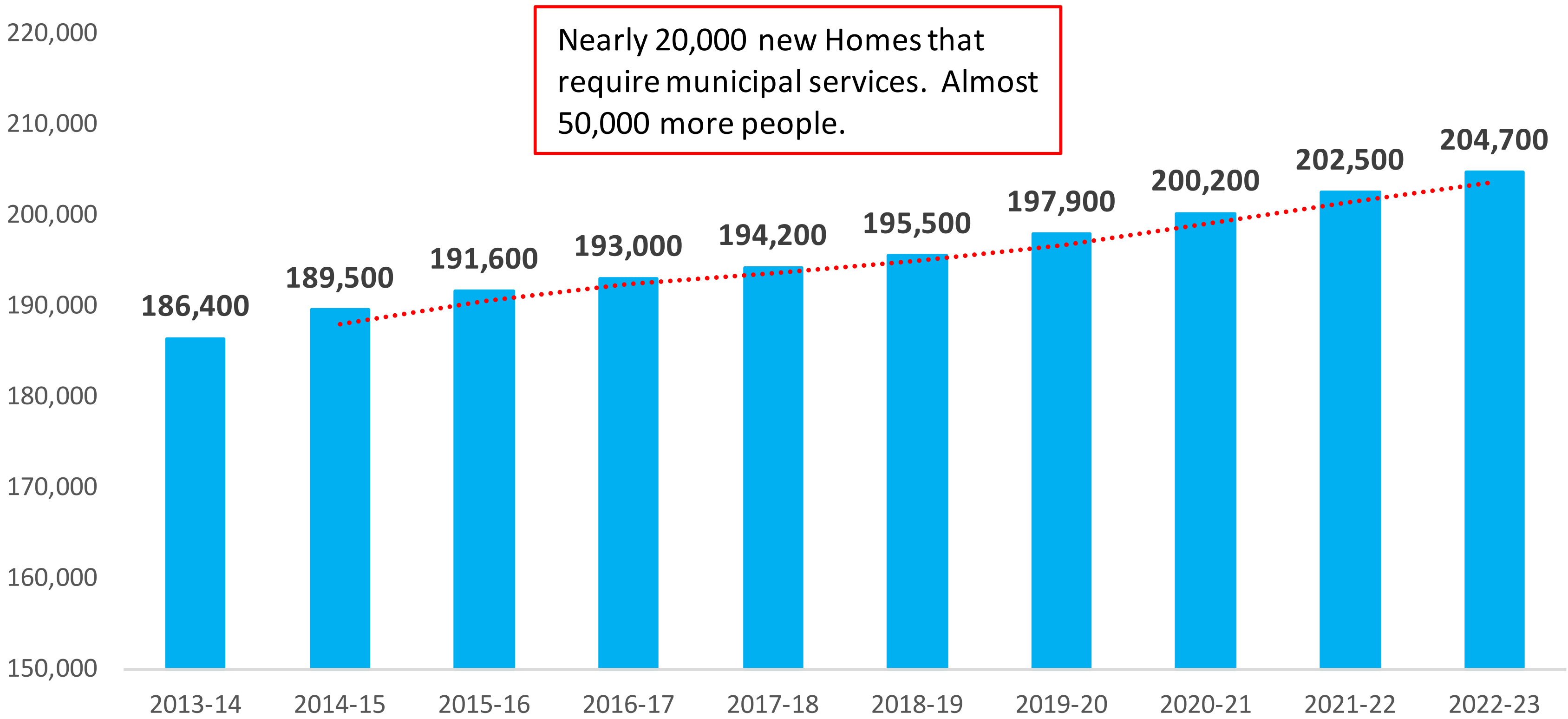


Economic Assumptions Remain Strong

	2018-19	Year 1 2019-20	Year 2 2020-21	Year 3 2021-22	Year 4 2022-23
Real Gross Domestic Product (GDP)	18,895	19,234	19,518	19,855	20,199
Personal Income per Capita	45,032	46,179	47,350	48,661	50,032
- Percent Change	1.9%	2.5%	2.5%	2.8%	2.8%
Inflation (CPI)	2.1%	2.1%	2.2%	2.2%	2.2%
Population (000)	438.0	444.0	449.0	455.0	460.0
Dwelling Units	195,529	197,887	200,199	202,464	204,706
- Percent Change	0.7%	1.2%	1.2%	1.1%	1.1%

Source: Canmac Economics, Conference Board of Canada, Financial Policy and Planning, HRM.

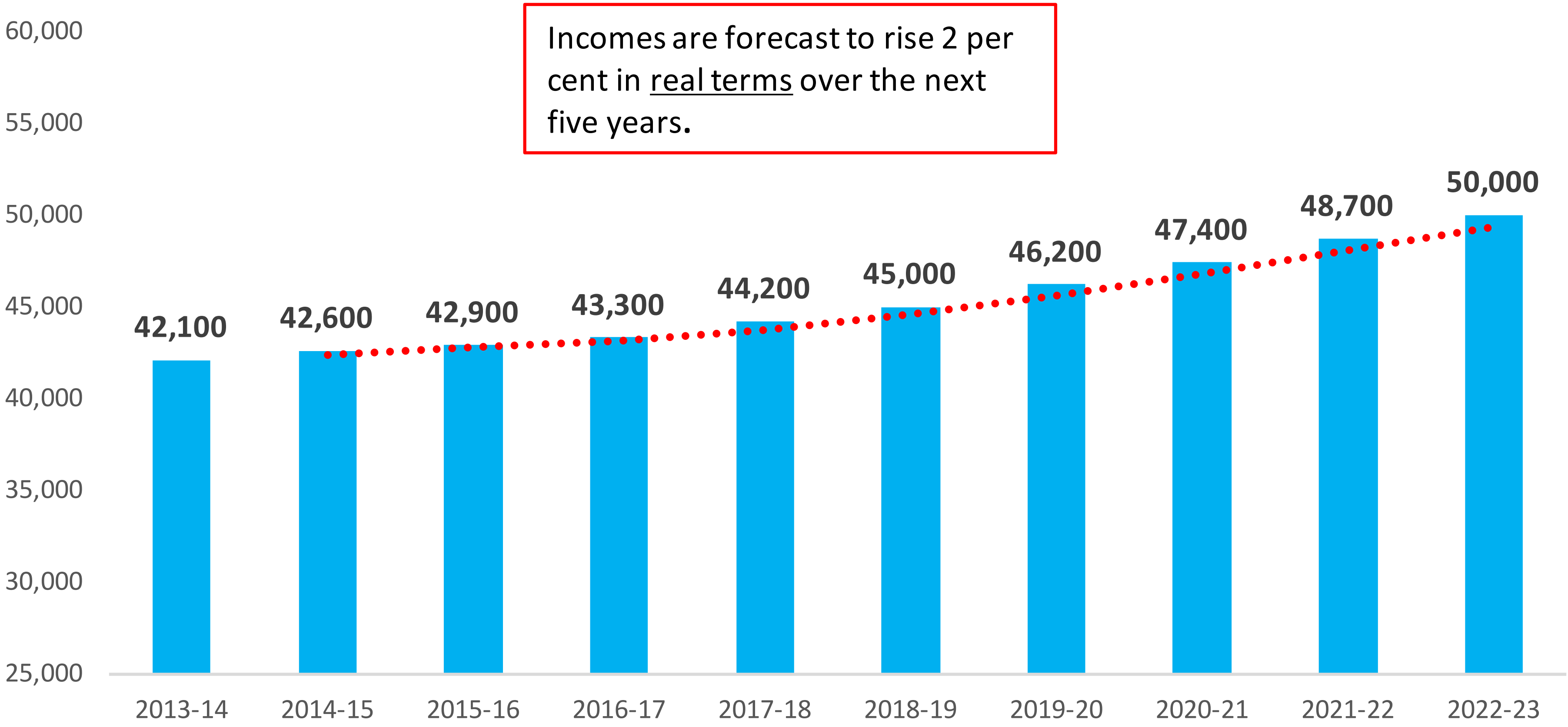
Nearly 20,000 New Homes



Sources: PVSC, Conference Board of Canada, HRM

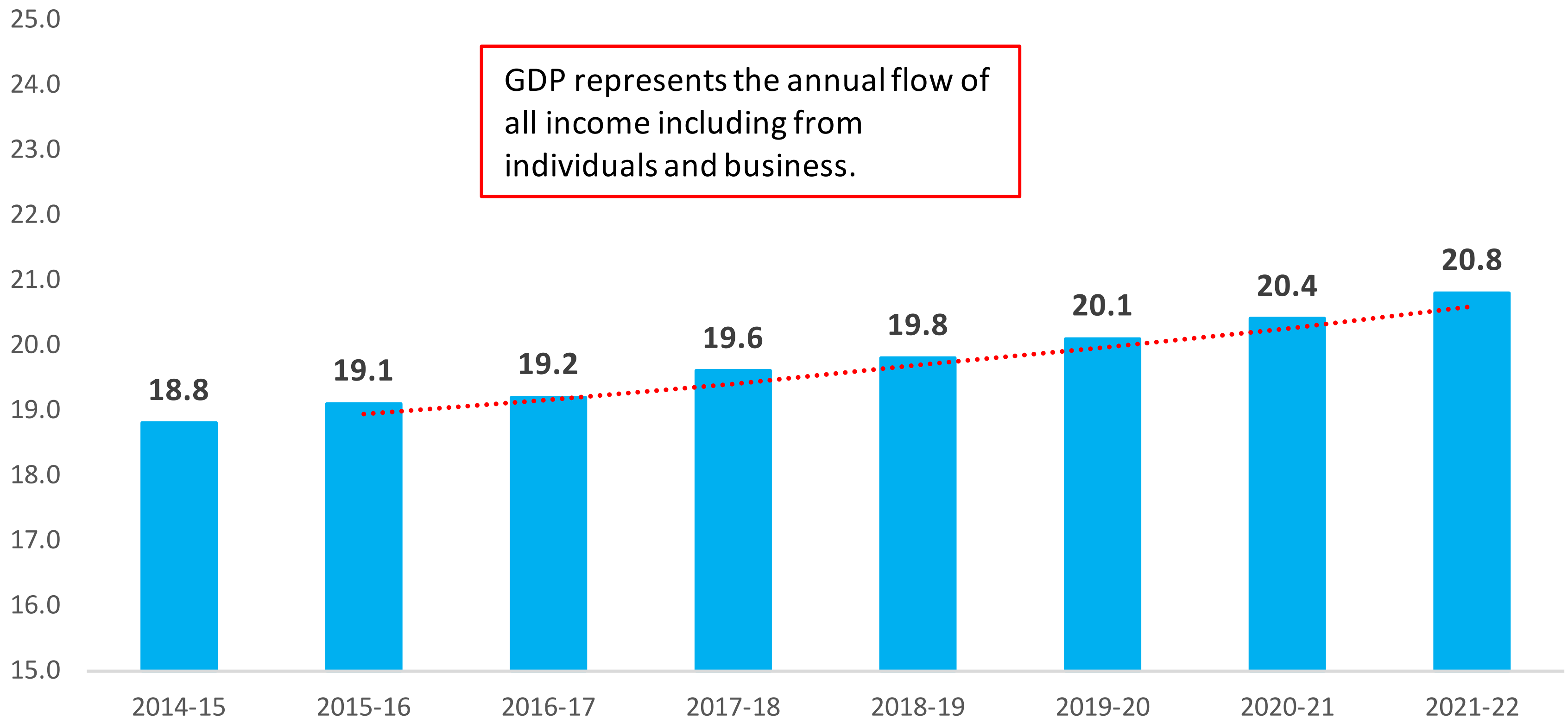
Incomes Are Growing

Incomes are forecast to rise 2 per cent in real terms over the next five years.



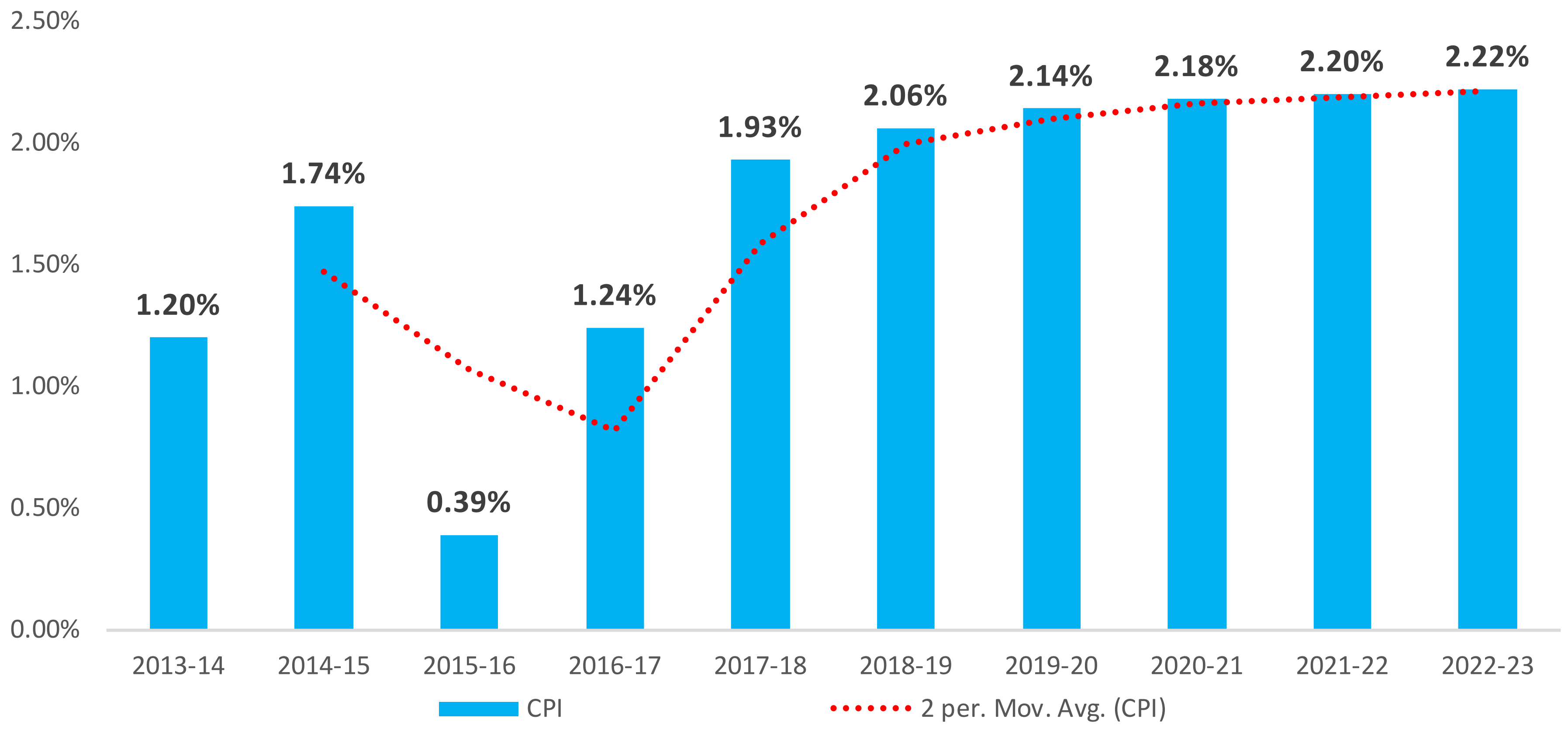
Sources: Conference Board of Canada

A Continual Rise in Real Gross Domestic Product (GDP)



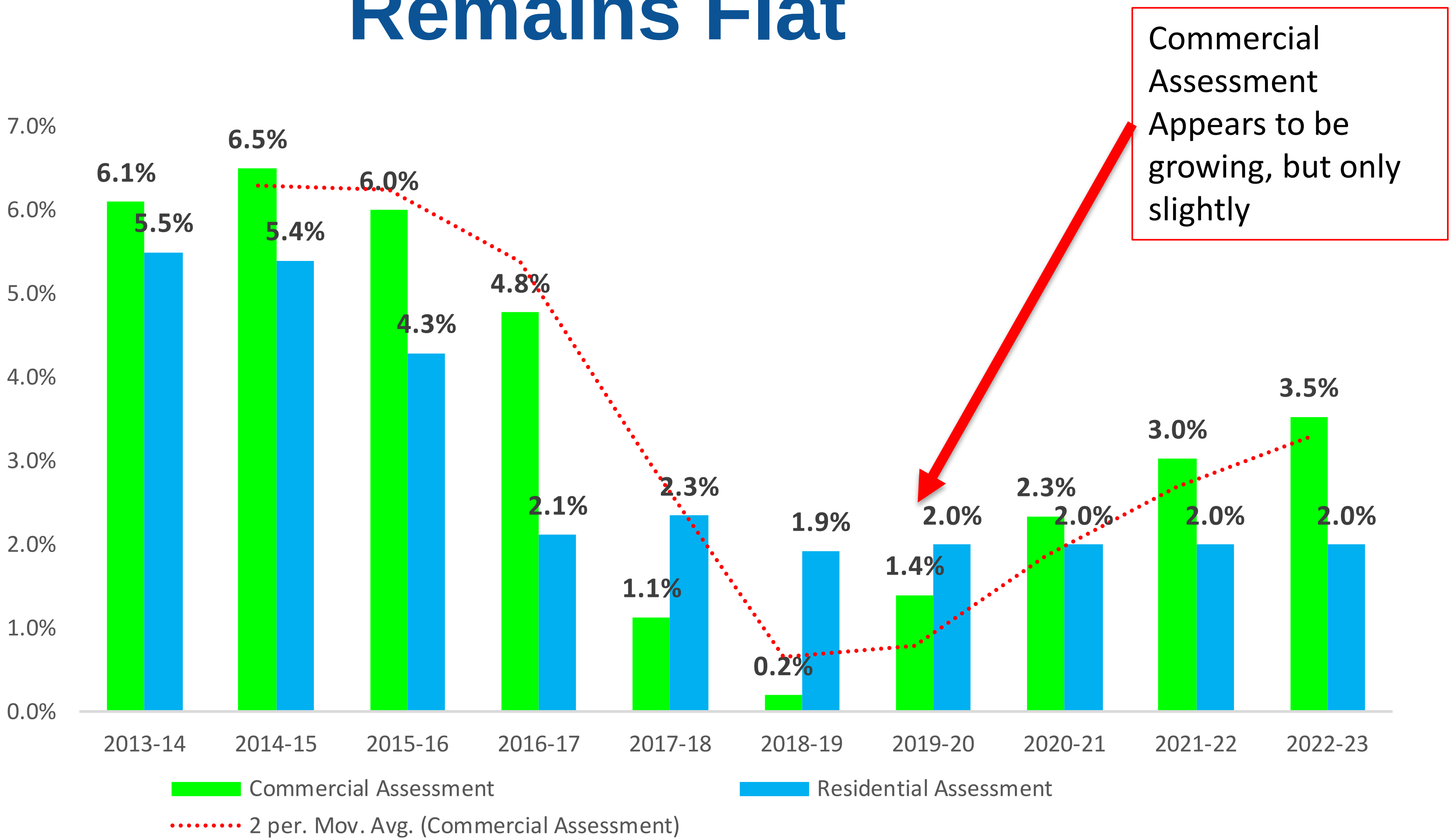
Sources: Canmac Economics

Inflation Expected to be Steady at 2.1%



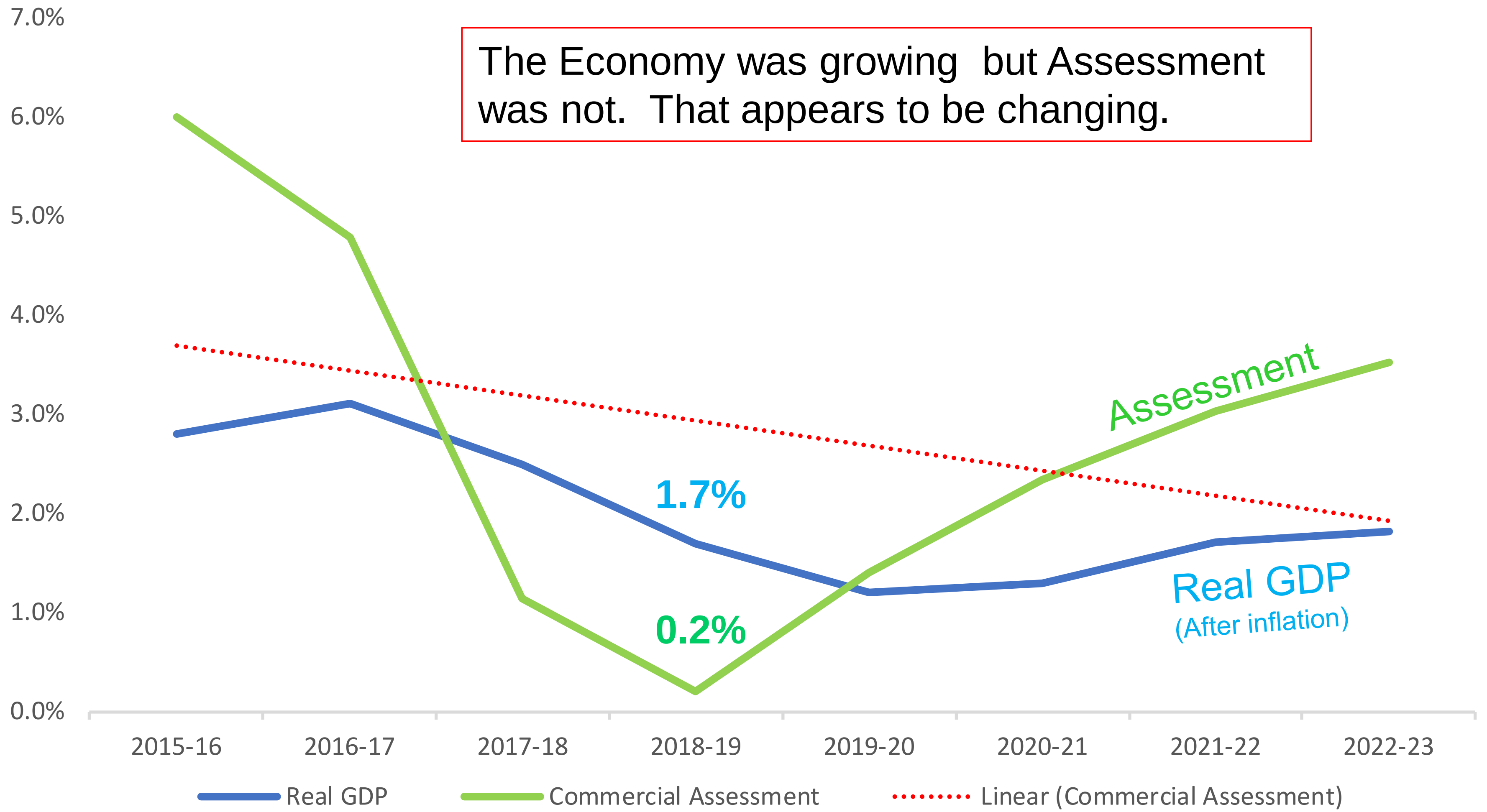
Sources: Statistics Canada, Conference Board of Canada, Canmac Economics MACRO Model Outlook

Commercial Assessment Remains Flat



Sources: Statistics Canada, Conference Board of Canada, Canmac Economics MACRO Model Outlook

GDP and Assessment Growth



Sources: Statistics Canada, Conference Board of Canada, Canmac Economics MACRO Model Outlook

HRM and Nova Scotia

- By Year Four of the Plan HRM has
  - Almost 50% of Nova Scotia’s population
  - Nearly 60% of Provincial GDP
  - Average income almost 10% higher
- Within ten years, HRM will have added 50,000 people. In themselves those 50,000 would become Nova Scotia’s third biggest municipality.
- By Year 4, a quarter of residents will have been born after amalgamation.

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The Challenges of Economic Growth

- Strong pressure on Prices
- Rising Incomes
  1. **<u>Wage and cost pressure for HRM</u>**
- Population growth significant
  - 50,000 over a ten year period
- New home construction
  2. **<u>Additional tax revenues</u>**
  3. **<u>Additional municipal services</u>**
- Considerable economic confidence
  4. **<u>Expectations of new and better services</u>**
  5. **<u>Expectations of investment in capital</u>**

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MULTI-YEAR BUDGET

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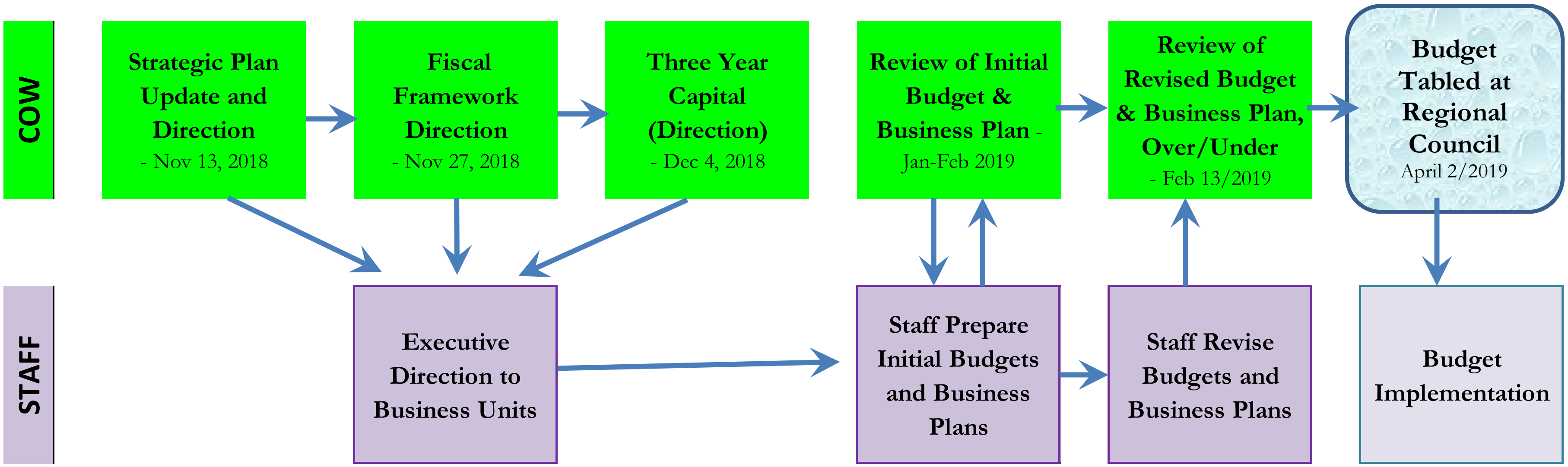
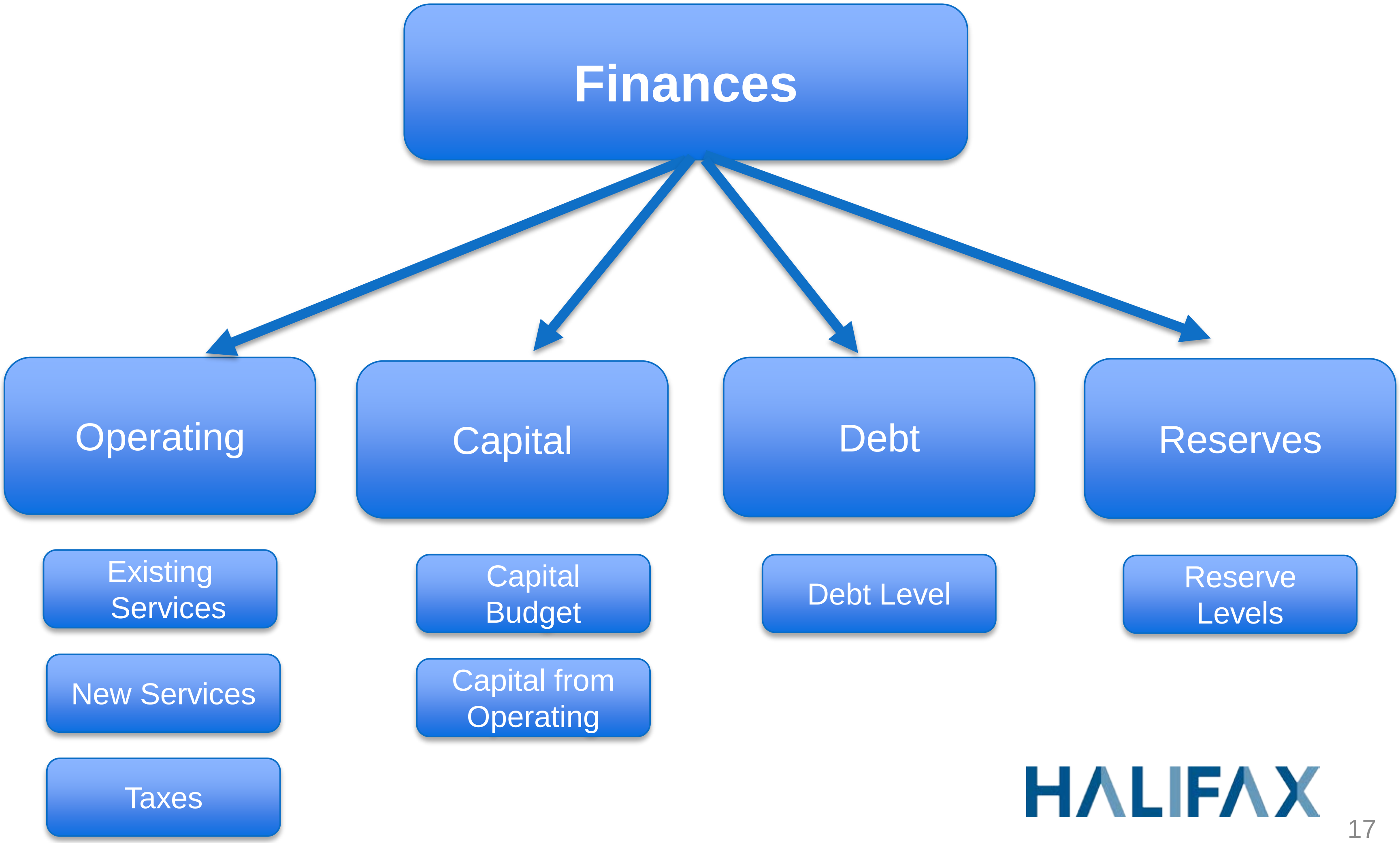
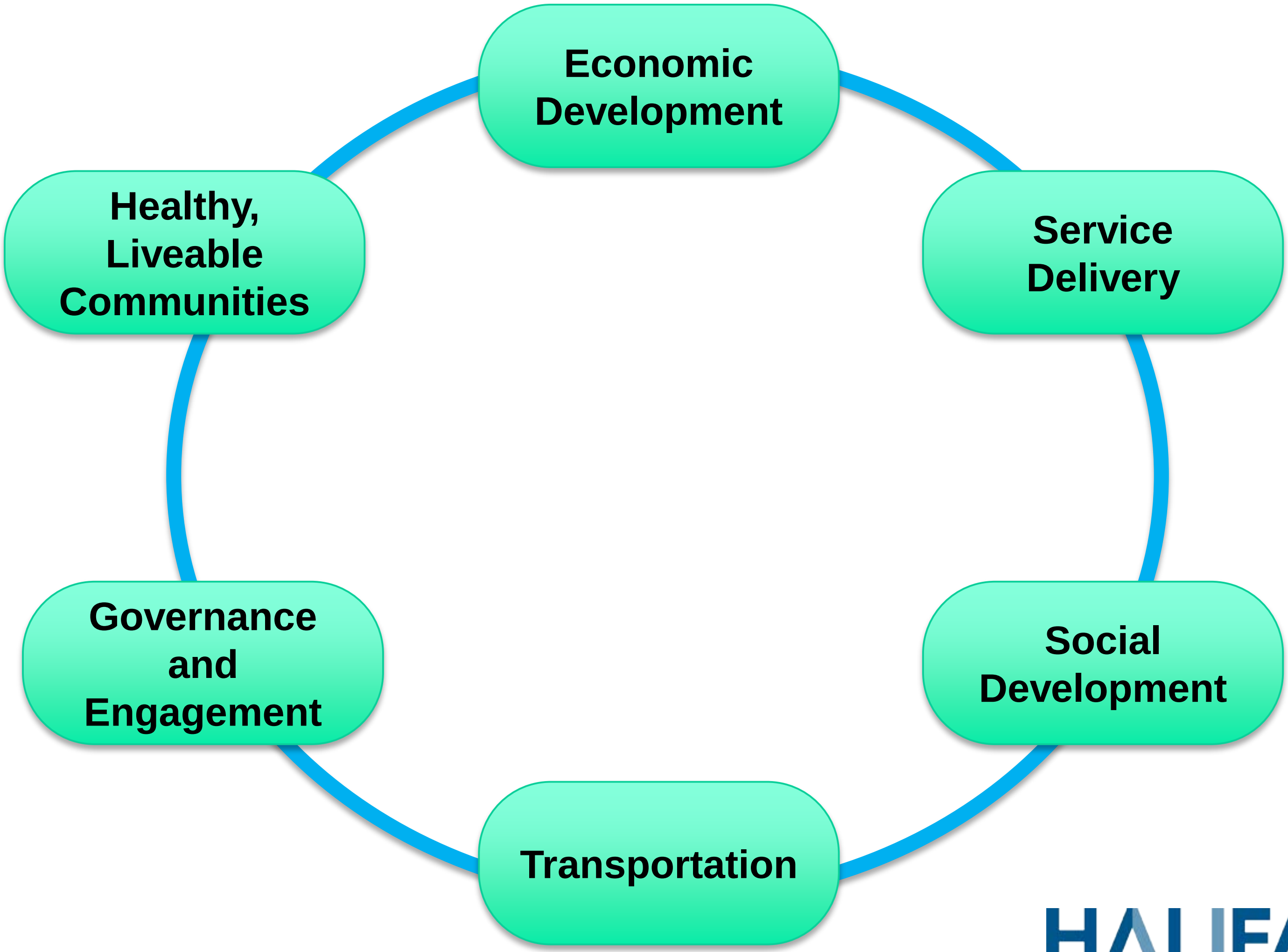
Budget and Business Planning Process



Decisions Inside Council's Control



Alignment with Council Priorities



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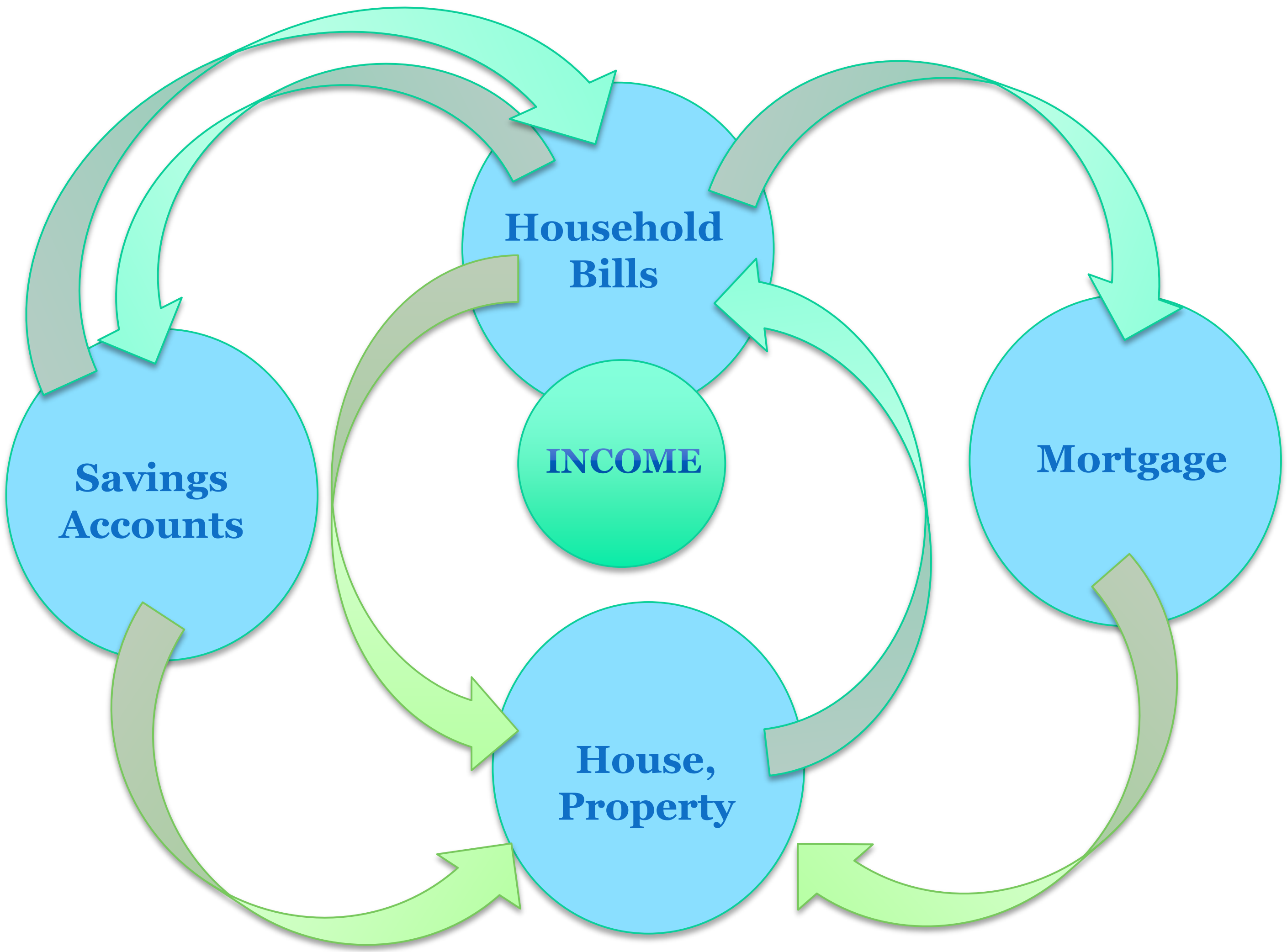
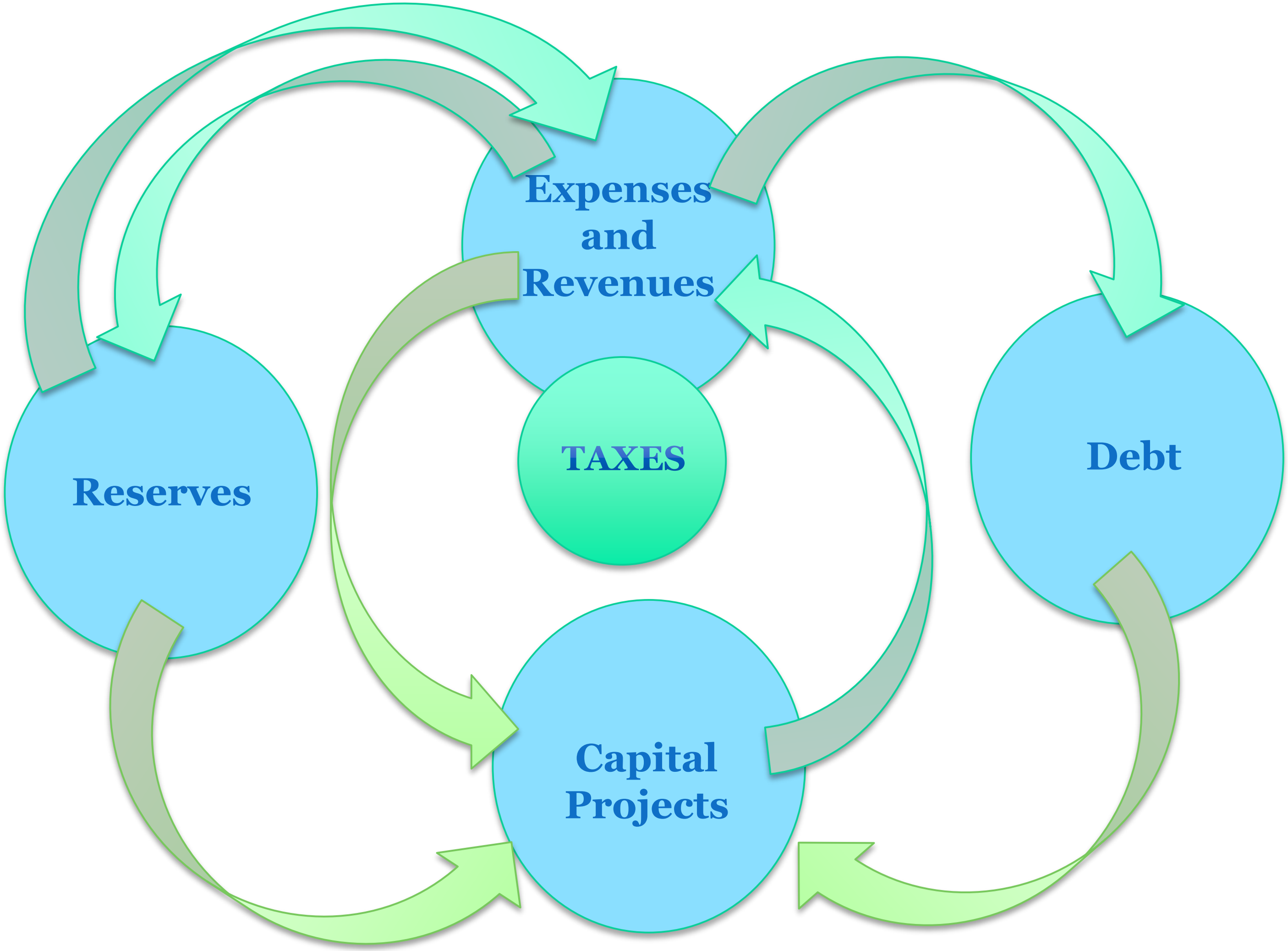
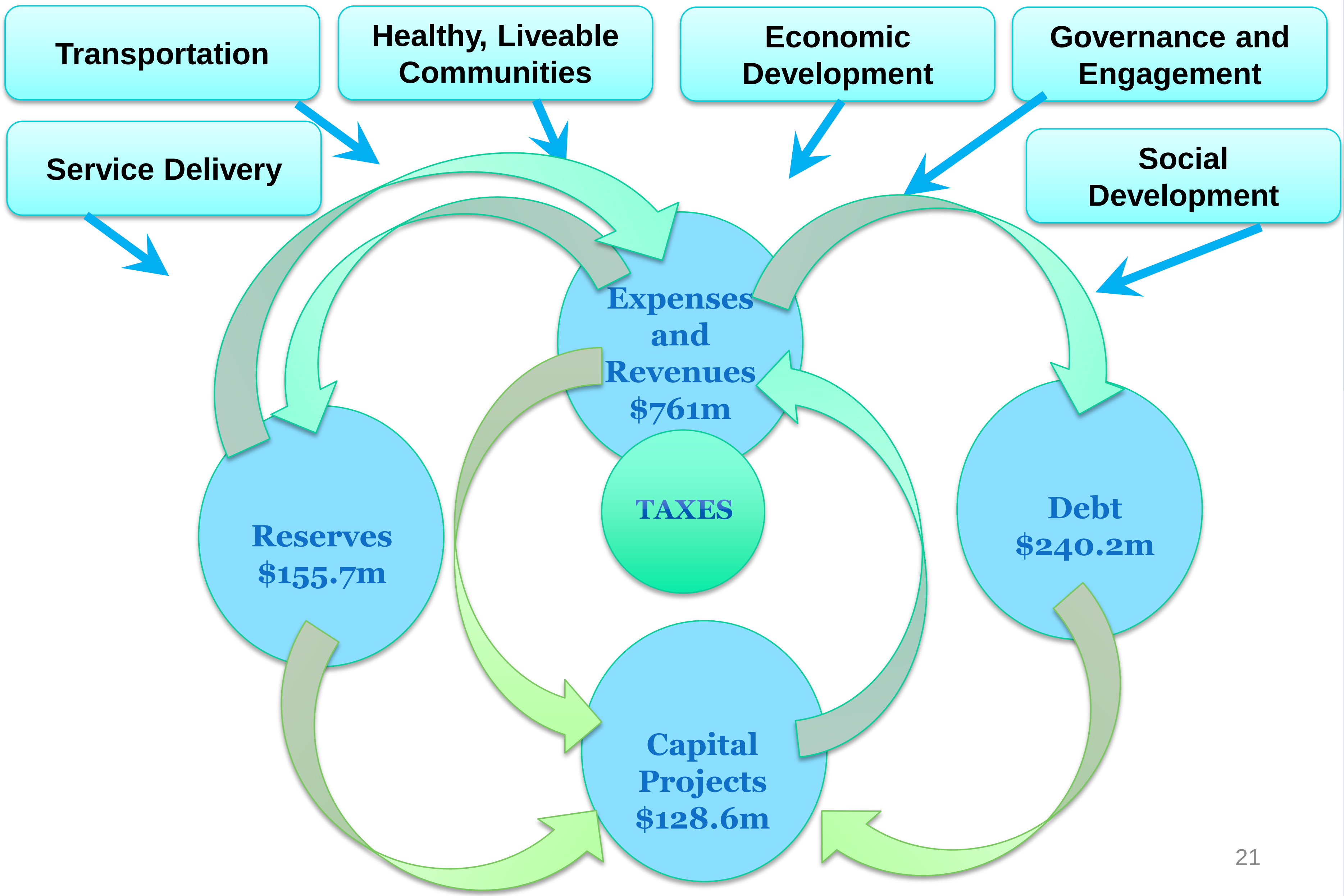
A Household Budget



A Municipal Budget



The HRM Budget – 2018-19



4 Critical Influences

Operating Budget

Property Tax Levels:
- Nearly 80% dependent on property tax
- Average single family home currently pays $1,917

Capital Budget

- Prioritizing maintenance of existing assets.
- Adding new assets to support growth which result in additional operating costs
- Funding includes **Debt** and **Capital from Operating**

Debt

- Debt is at acceptable levels and in alignment with Council approved debt strategy

Reserves

- Used to manage risk, provide for future obligations and opportunities

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The 7 Key Council Decisions

Operating Budget

1. **Taxes** – Should taxes rise, fall or stay the same?
2. **Services (Existing)** – How can value be optimized?
3. **Services (New)** – Will new services be funded?

Capital Budget

4. **Capital Budget** – How much should be invested in Asset Renewal and Growth?
5. **Capital from Operating** – How much should HRM pay down on the Capital Budget?

Debt

6. **Debt** – What level of debt does HRM wish to approve?

Reserves

7. **Reserves** – What reserve balances does HRM expect?

OPERATING

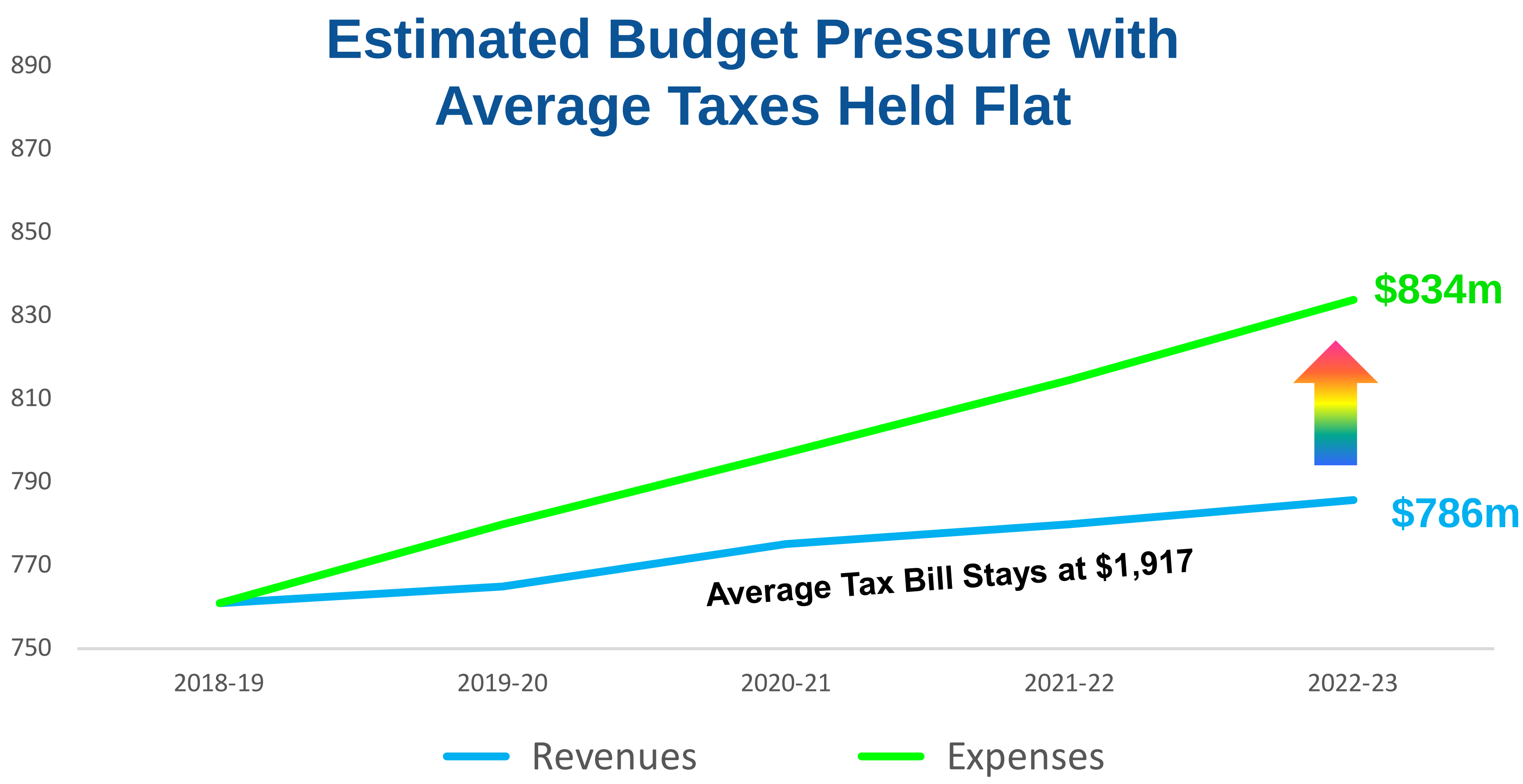
Four Year Overview

	Approved 2018-19	Year 1 2019-20	Year 2 2020-21	Year 3 2021-22	Year 4 2022-23
Operating Budget Gap (Millions)	0	15	22	35	48
Average Property Tax Bill	$1,917	$1,917	$1,917	$1,917	$1,917
Net Capital Budget (Millions)	$99	$89	$92	$90	$93
Debt (Millions)	$240	$236	$231	$227	$222
Per Dwelling	$1,228	$1,191	$1,155	$1,120	$1,086
Debt Ratio (Tax Supported)	4.2%	4.0%	3.9%	3.8%	4.0%
Reserves (Millions) - DRAFT	$153	$136	$144	$150	$140

The Next Four Years

	Approved 2018-19	Year 4 2022-23	
Operating Budget Gap (Millions)	0	48	
Average Property Tax Bill	$1,917	$1,917	
Property Tax Revenues	$519m	$531m	$12m +
Existing and New Homes and Businesses	519.1	531.1	
Services Provided	$497m	$565m	
Existing Services (net cost)	496.9	551.2	
Salaries and Benefits	387.5	433.7	$46m +
External Services	114.8	119.0	
Gasoline, Diesel, Heating Fuel	11.6	15.9	$4m +
Other costs	86.0	93.0	$4m +
Fees, Fines, other revenues	-103.0	-110.4	
New or Expanded Services		13.4	$13m +
Fiscal Items	$22m	$15m	$7m +
Debt Charges - to repay debt (Capital Budget)	49.4	46.1	
Capital from Operating - for the Capital Budget	36.2	39.5	
Reserves - for risk, opportunities, obligations	16.9	18.8	
Deed Transfer Tax	-37.0	-40.3	
Other expenses and revenues (net)	-43.3	-49.6	

The Medium Term Trend



Year 1 - 2019-20

	Approved 2018-19	Year 1 2019-20	
Operating Budget Gap (Millions)	0	15	
Average Property Tax Bill	$1,917	$1,917	
Property Tax Revenues	$519m	$522m	$3m +
Existing and New Homes and Businesses	519.1	521.9	
Services Provided	$497m	$521m	
Existing Services (net cost)	496.9	513.3	
Salaries and Benefits	387.5	402.5	$15m
External Services	114.8	114.5	
Gasoline, Diesel, Heating Fuel	11.6	14.6	$3m
Other costs	86.0	85.7	$2m +
Fees, Fines, other revenues	-103.0	-103.8	
New or Expanded Services		7.9	$8m
Fiscal Items	$22m	$16m	$6m +
Debt Charges - to repay debt (Capital Budget)	49.4	46.4	
Capital from Operating - for the Capital Budget	36.2	37.0	
Reserves - for risk, opportunities, obligations	16.9	18.2	
Deed Transfer Tax	-37.0	-39.0	
Other expenses and revenues (net)	-43.3	-47.0	

Compensation is a significant Cost Driver

- Compensation is 50% of the Municipal Budget
- HRM has seven collective agreements. Average increase:
  - Police – 2.75%
  - IAFF – 4.5%
  - ATU – 3.6%
  - NSUPE – 2.0%
- New positions and step increases contribute to wage costs.
- Pension costs remain substantial.

Compensation as a Percent of Budget

Transportation & Public Works*	22%
Corporate and Customer Service	45%
Legal	53%
Parks & Recreation	55%
Halifax Transit	68%
Finance & Asset Management	70%
Library	74%
CAO	83%
Planning & Development	83%
Human Resources	87%
Police	92%
Auditor General	93%
Fire and Emergency	95%

* **Note:** TPW includes Contracts for Solid Waste, Winter Works and other services.

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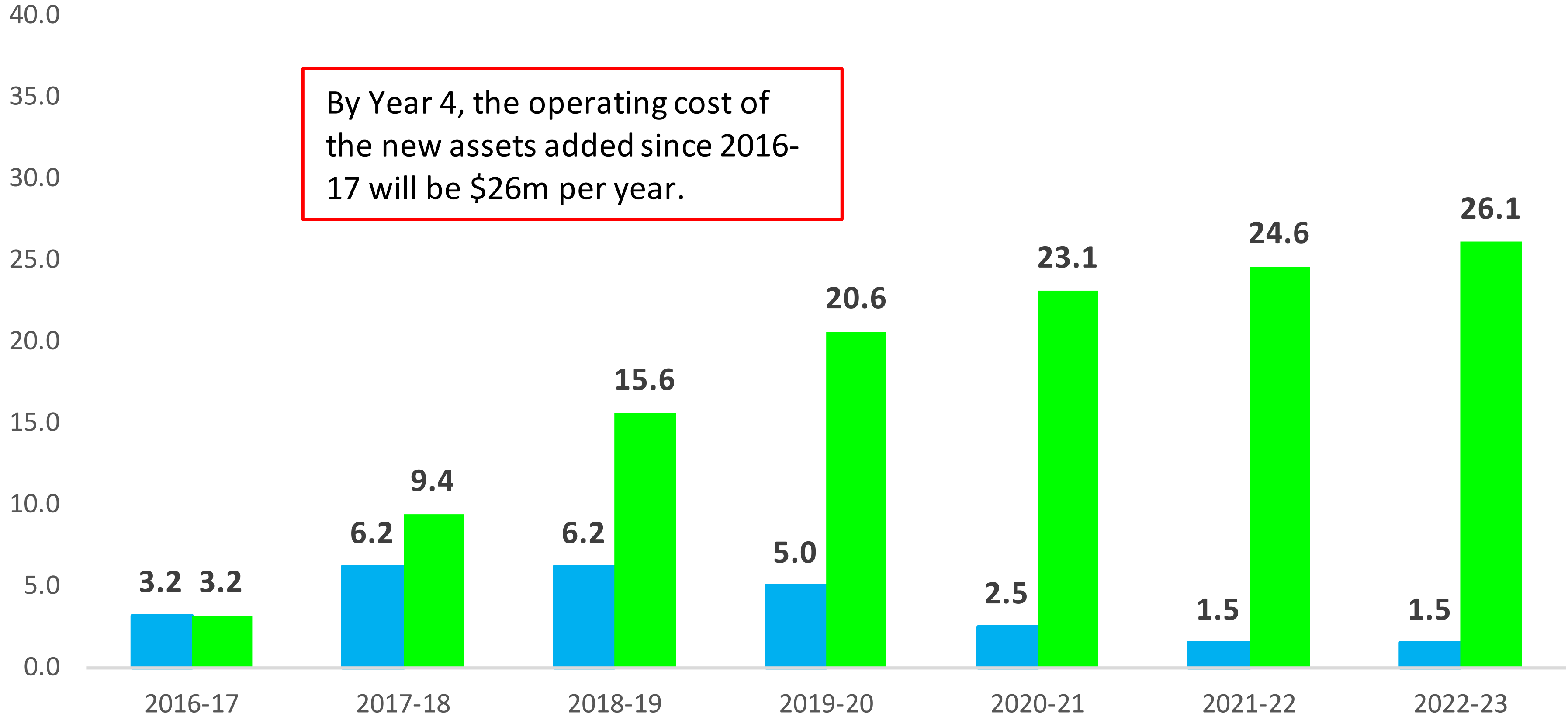
New Services

	Year 1 2019-20	Year 2 2020-21	Year 3 2021-22	Year 4 2022-23
New/Higher Services	$ Millions			
RCMP - six new officers (funded Jan 2018 for three months)	0.7	0.7	0.7	0.7
Budget Adjustment List, 2018-19 (funded from reserves in 18-19)	0.7	0.7	0.7	0.7
Operating Cost of Capital (est operating cost for new assets)	3.5	6.0	7.5	9.0
New Positions (various)	2.6	2.6	2.6	2.6
Other	0.4	0.4	0.4	0.4
Total	**7.9**	**10.4**	**11.9**	**13.4**

Operating Costs for New Assets



Sources: HRM

Life Cycle Cost of a Transit Bus

Purchase Price
$620,000

14 Year Operating Cost (Drivers, Maintenance, Fuel)
$3.0 Million

Note: Excludes cost of bus replacement, re-build or any expansion of transit garage, debt costs, overhead, etc..

Cost Pressures and Savings

Cost Pressures/(Savings)	$ Millions
Collective Agreements (eg Police 2.75%, Fire -4.5%, ATU - 3.6%, Steps)	15.0
Other pressures (eg RCMP contract, PILT, software, Purdy's lease)	4.0
Fuel (Gasoline +17%, Diesel/Heating Fuel +27%)	3.0
Capital from Operating	0.8
Deed Transfer Tax	-2.0
Performance Excellence	-1.4
Debt (net of recoveries)	-2.7
Other Savings (eg 19/20 surplus, revenues, valuation allowance, investment income)	-7.3
Total	**9.5**

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Review of 2017-18 Surplus

Summary of 4th Quarter Surplus

Deed Transfer Tax	(8,971)
Other Savings	(3,738)
Due to Weather	(2,240)
Already Included in 18-19 Budget	(1,320)
One Time Savings	(621)
Transit Fare Shortage	1,100
Fire Overtime Spending	2,800
Planning Revenue Shortage	3,200
Total	**(9,790)**

- Reviewed past surplus to see if any savings could be repeated in 2019-20
- Deed Transfer accounted for $9m of the Q4 surplus
- Some savings were identified for use in 2019-20. These included higher revenues, lease costs, other.
  - Budgeted $3m surplus

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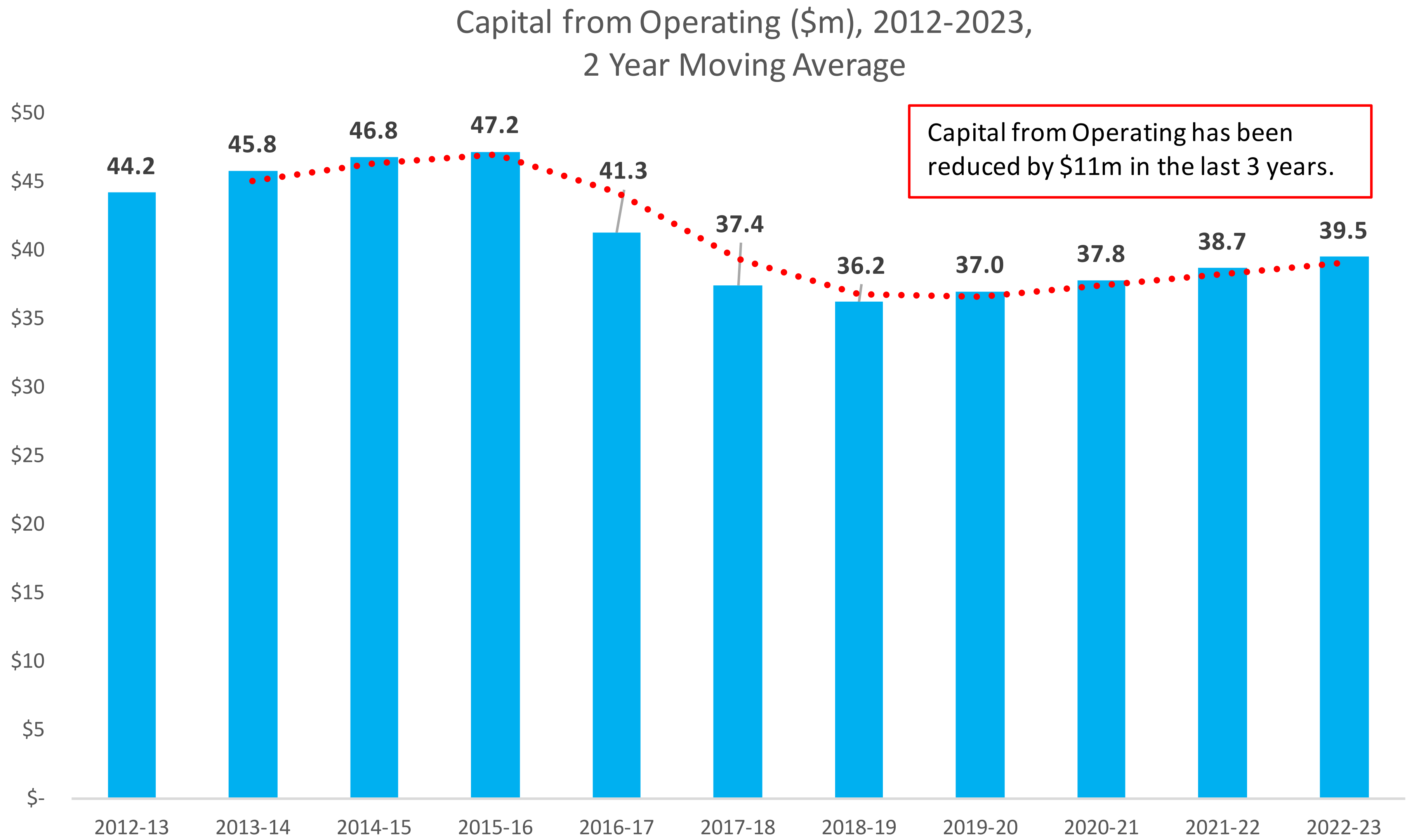
Capital from Operating



Deed Transfer Tax

- Tax of 1.5% on property sales

- Revenues tend to be cyclical, rising and then falling
  - Dependent on not just home sales, but a few sales of large commercial properties.
    - $6m from one sale in 2018-19
  - Difficult to forecast or depend on

- Internal economic forecast suggests it will continue to rise slightly in Years 1 and 2 and than reduce.

  - Funds in excess of budget could be placed in reserve or use to support the Capital Budget
    - 2018-19 - $10.0m
    - 2019-20 - $ 3.0m
    - 2020-21 - $ 0.5m

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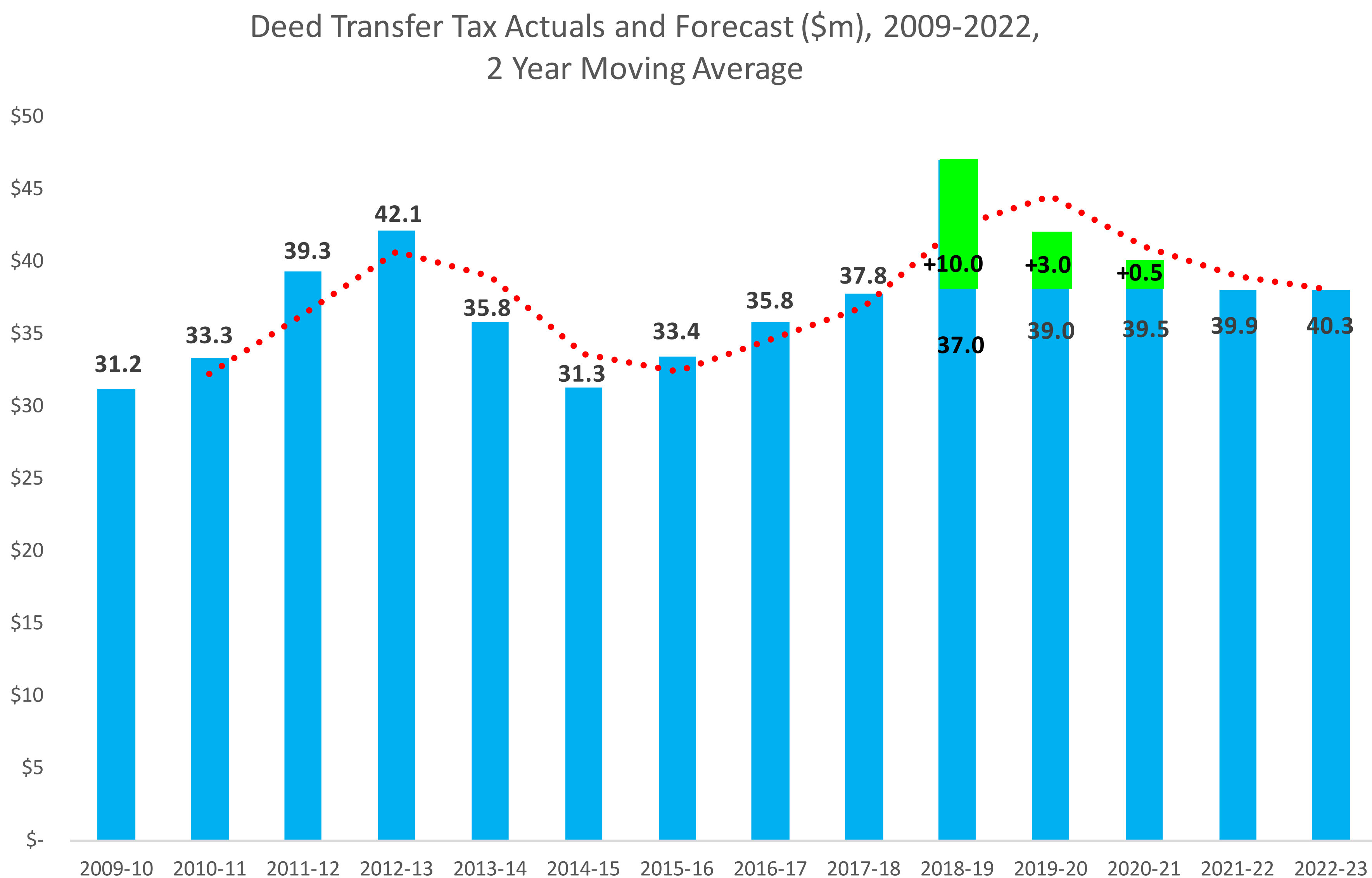
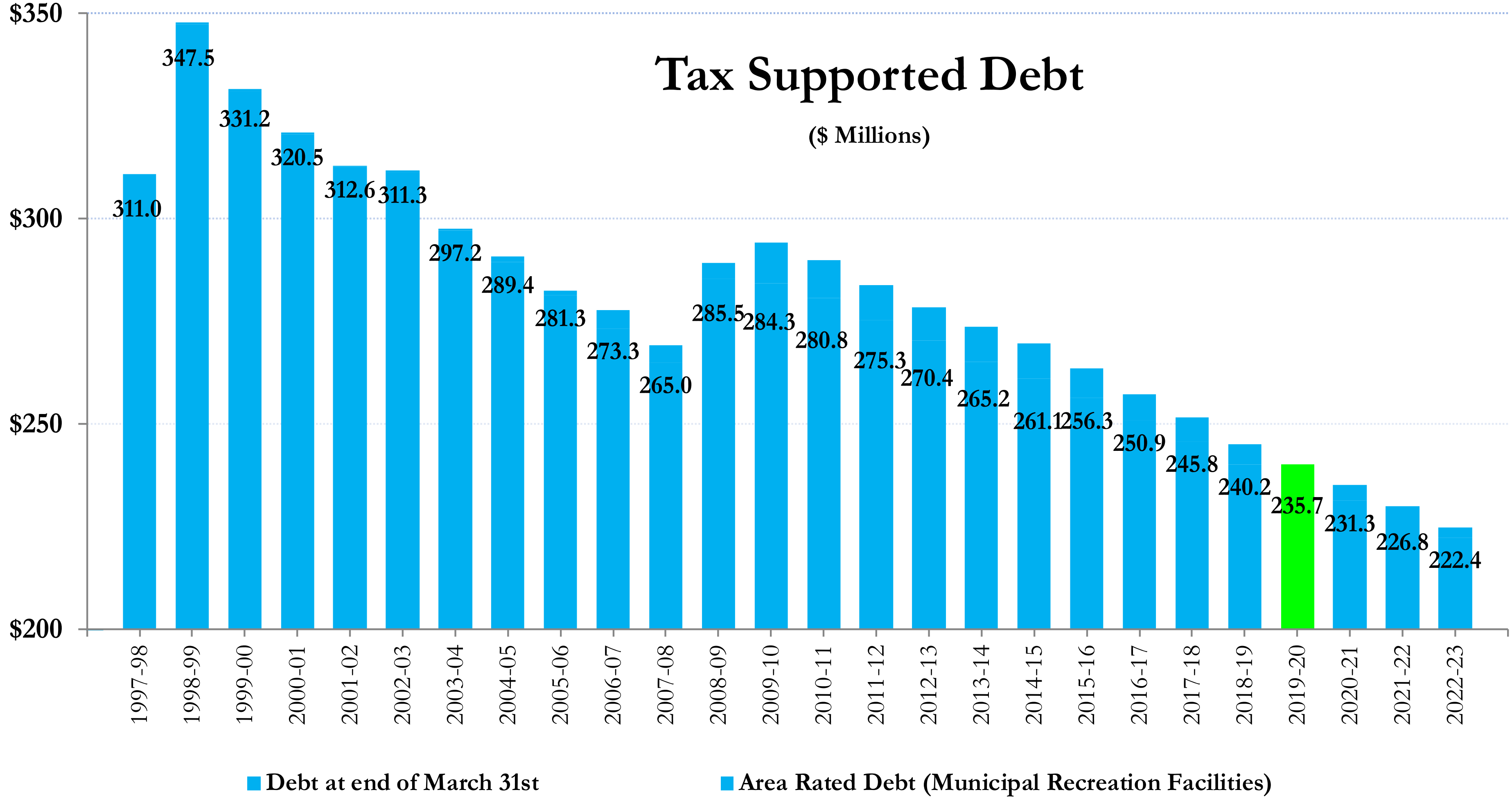
Deed Transfer Tax



DEBT

Debt



Debt includes funding that is approved, issued and work-in-progress (WIP) as of March 31st year-end.

September 2018 Temporary Borrowing Resolution is for $173m, including non-tax supported debt.

CAPITAL

Capital

- **December 4, 2018 -Three Year Balanced Capital Budget**
- **Main Sources of Funding:**
  - Additional Debt
  - Capital from Operating
  - Gas Tax
  - Reserves
  - Infrastructure Funding
- **Options for Additional Capital Funding**
  - Issue Additional Debt
    - One-time debt or change policy
    - Will lead to higher operating costs
  - Use Reserves
  - Place excess Deed Transfer Tax into Capital Budget
    - Capital from Operating or Reserves

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OPTIONS FOR FOUR YEAR SUSTAINABILITY

Option One – Reduce Services

- Cost pressure is significant and ongoing
- **Reduce Business Unit <u>service costs</u> by $48m over four years**
  - Represents a **<u>8.5% reduction in costs</u>**
  - Without tax increases there will be ongoing service reductions
- **Can reduce <u>Capital from Operating</u>, hence capital projects**
  - If new capital assets are reduced, there will be savings in operating cost of capital, a significant cost driver
  - Reductions in Asset Renewal could increase some operating costs and decrease asset condition
- **Citizen Survey:**
  - 53% said to “Maintain taxes and fees, even if it means reducing some services to maintain others”

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Option Two – Increase Property Taxes

- Cost pressure is significant and ongoing
- HRM is nearly 80% dependent on taxation
- Increase in average tax bill
  - 2019-20 – 2.9% increase, $56 per home
  - Years 2 to 4 – Increase by inflation (i.e. 2.2%)
- Increase is slightly higher than inflation but in line with the growth in personal income
- Provides for a more sustainable financial path
- Regional Council can specify combination of services changes and tax increases

Residential Tax

Average Assessments and Tax Rates

	Base Year 2018-19	Year 1 2019-20	Year 2 2020-21
Average Assessment (Single Family Home)	$234,500	$238,900	$245,400
* Urban Tax Rates[1]	0.8175	0.8260	0.8220
Average Tax Bill	1,917	1,973	2,017
Change $		56	44
Change %		2.9%	2.2%

The property tax rates will be adjusted to offset any assessment increase.

[1] Includes Urban General Tax Rate, Local Transit and Regional Transit Tax Rates

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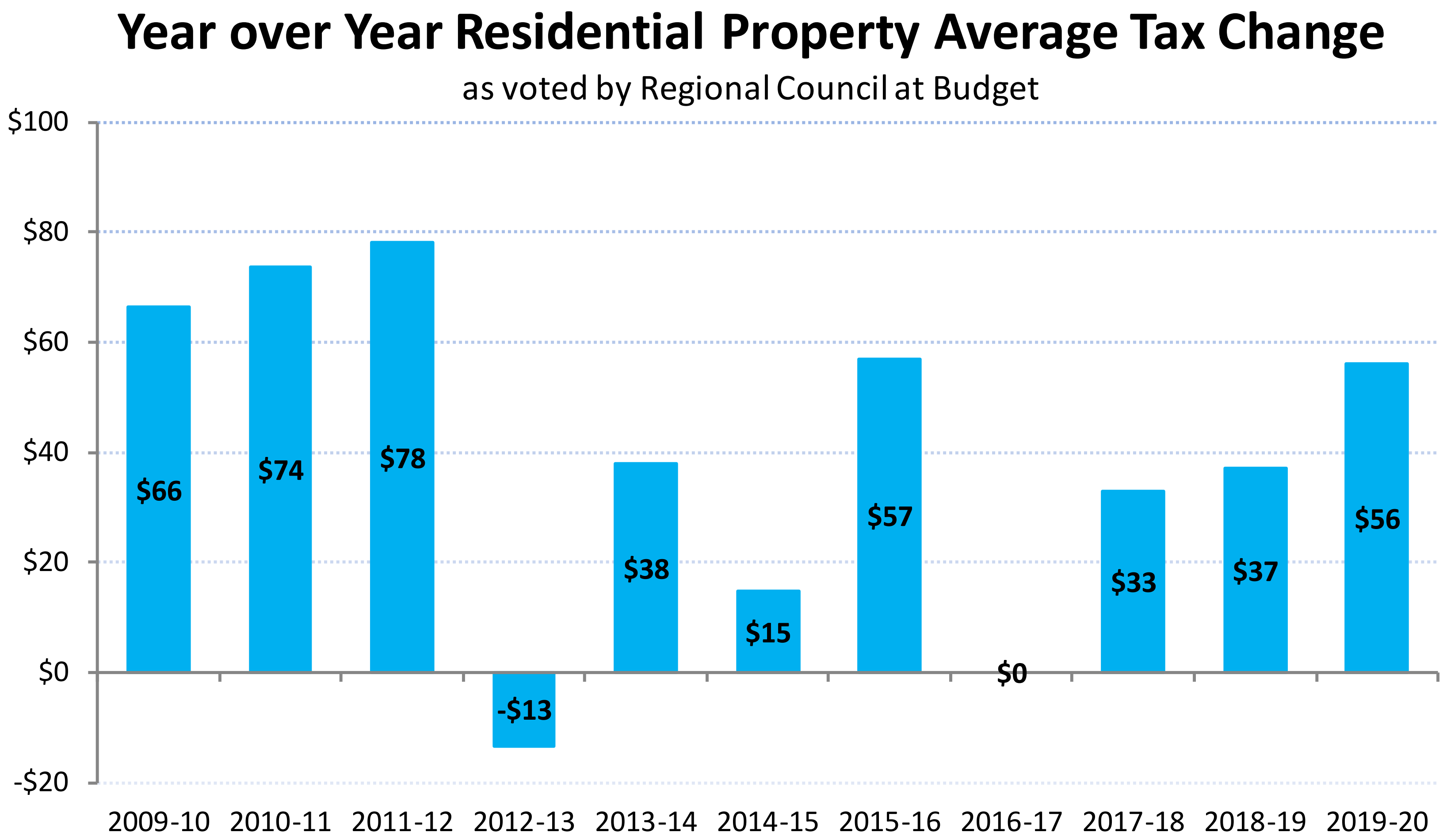

Note: Based on year to year assessment changes at budget time. Not re-stated for assessment growth.

Commercial Tax

Average Assessments and Tax Rates

	Base Year 2018-19	Year 1 2019-20	Year 2 2020-21
Average Assessment (Commercial)	$1,428,322	$1,445,462	$1,476,395
* Urban General Tax Rate	2.9255	2.9750	2.9740
Average Tax Bill	**41,786**	**43,002**	**43,908**
Change $		1,217	905
Change %		2.9%	2.1%

The property tax rates will be adjusted to offset any assessment increase.

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Conclusions

- **Strong Economic Growth, but with a Price**
  - **New services** are being added from past budgets
  - **Ongoing wage pressures** are considerable
  - **Fuel** cannot be easily avoided

- **Factors Influencing Budget Costs will Continue**
  - Options – reduce services or raise taxes
  - Keys to winning the "Long Game":
    - o Stronger planning and budgeting,
    - o Linking tax decisions to inflation, growth, services, and,
    - o Making difficult trade-offs around priorities

Recommendation

- It is recommended that Halifax Regional Council direct staff to develop the 2019-2020 Budget and 2020-21 Budget in Principle according to Council's approved priorities, and preliminary fiscal direction, including:
  - maintaining the appropriate level of existing services with the addition of the new services previously approved by Council;
  - a three-year capital budget that recapitalizes assets, funds growth related issues and is balanced to the fiscal framework;
  - a responsible debt position;
  - appropriate reserve balances that allow for risk mitigation, future obligations and opportunities; and,
  - alignment of the current average tax bill for residential homes and commercial properties under two scenarios:
    a) 2.1% increase for 2019-20;
    b) 2.9% increase for 2019-20.

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