HALIFAX

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Item No. 4
Budget Committee
December 15, 2020

TO: Chair and Members of Budget Committee
(Standing Committee of the Whole on Budget)

SUBMITTED BY: Original Signed by

Jacques Dubé, Chief Administrative Officer

DATE: November 30, 2020

SUBJECT: Fiscal Sustainability Strategy

ORIGIN

During the 2020/21 Budget debate staff indicated they were developing a “Capital Funding Framework” with a review of debt and reserve policies and other revenue and funding sources and their relationship to fiscal sustainability and a long-term capital plan.

LEGISLATIVE AUTHORITY

Halifax Charter, section 93(1) - The Council shall make estimates of the sums that are required by the Municipality for the fiscal year; Halifax Charter, section 79A (1), subject to subsections (2) to (4), the Municipality may only spend money for municipal purposes if (a) the expenditure is included in the Municipality's operating budget or capital budget or is otherwise authorized by the Municipality;

Halifax Charter, section 35(2)(d)(i) - The CAO can only authorize budgeted expenditures or within the amount determined by Council by policy;

Halifax Charter, section 120(6) - The Municipality may maintain other reserve funds for such purposes as the Council may determine;

RECOMMENDATION

It is recommended that Budget Committee direct the CAO to:

1. Develop, “Strategic Initiative" Reserves, as part of the 2021/22 budget process, for projects that are tied to an approved Council strategy and are significant enough to lead to a discernable increase in the tax rate or special funding that is outside the normal budget process. This should include any required changes to debt and reserve policies and should be eligible to be funded through dedicated tax levies.

RECOMMENDATIONS CONT’D ON PAGE 2

2 Starting with the 2021/22 budget and replacing the two-year detailed budget, develop a long-term Financial Plan, focused on sustainability, that includes a one-year Budget, a three-year outlook and a long-term plan based on Council's Strategic Vision that supports the operating, capital and reserve budgets and allows the Municipality to meet its long-term goals.

3 For the 2022/23 budget, provide a Tax and Fee Revenue Strategy to Budget Committee that will establish guiding principles for user fees and property taxes.

BACKGROUND

During the 2020/21 Budget debate staff indicated that it was preparing a Capital Funding Framework that would look at debt and reserve policies and other revenue and funding sources including their relationship to fiscal sustainability and a long-term capital plan. The proposal was included in the 2020/21 Proposed Operating Budget that was to have been ratified by Regional Council on March 24, 2020. Following the onset of the pandemic, the budget was recast and the proposal for a Capital Funding Framework was not ratified. The Fiscal Sustainability Strategy represents a broadening of the Capital Funding Framework to include a greater focus on operating and revenue issues.

DISCUSSION

According to the association of Chartered Public Accountants of Canada, fiscal sustainability is the ability to provide and maintain existing programs without resorting to unplanned increases in rates or cuts in services. It puts a "speed limit" on municipal spending and lays the foundation to achieve the long-term goals of the community and safeguard its future. Further detail is found in attachment A.

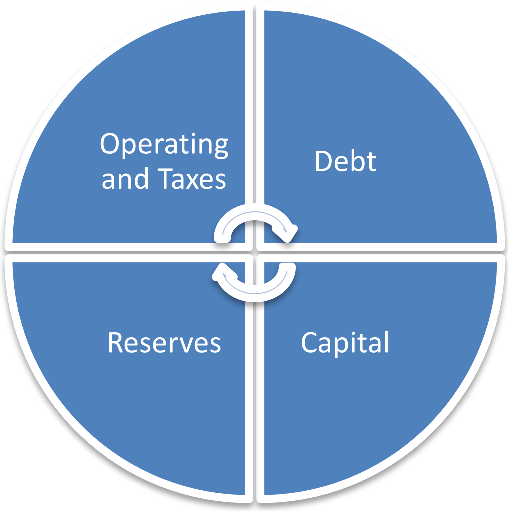
The Fiscal Sustainability Strategy examines the current financial state of HRM by examining four key areas of financial management or "levers": (1) Operating and Taxes, (2) Capital, (3) Reserves, (4) Debt. Each of these areas are interrelated.

- **Operating and Taxes** – The operating budget sets out the cost of running the municipality. The budget includes items to operate services such as salaries and benefits, fuel, commodities, contracting, consulting, and general office expenses. These costs are offset by municipal revenues, such as user fees, fines and transit fares. The largest revenue source is property taxes, which represents nearly 82 per cent of total revenues.

- **Capital** – The capital budget is an expenditure plan for investment in long-term assets, such as buildings, parks, streets and roads or technology. These assets are critical in the delivery of municipal services.

- **Reserves** – These are funds put aside for future use, using current-year revenues. These funds may be held to offset potential risks ("rainy day funds"), to pay for future obligations (e.g. landfill closures) or for possible opportunities (i.e. HRM's share of federal/provincial infrastructure programs).

- **Debt** – HRM may borrow (issues debentures) for the purchase of its long-term capital assets. All debentures are issued through the Nova Scotia Municipal Finance Corporation (NSMFC), a provincial agency.



Operating and Taxes

In June 2020/21 HRM approved its recast budget, a $955.5 million operating budget. Significant costs included compensation ($405.4 million), mandatory provincial costs ($168.2 million), external services ($121.5 million). Included were a net reserve contribution of $23.1 million, $44.5 million in payments for debt costs; $19.8 million in transfers to the capital budget and $2.7 million budgeted to cover the operating costs of new assets.

Total HRM budgeted costs (less provincial mandatory costs) were $787.3 million in 2020/21, known as Total Municipal Expenditures (the "Municipal Budget"), which represents the costs to fund municipal services. HRM costs are influenced by several factors:

- Growth in the population, number of homes and businesses,
- Economic factors, including inflation and the costs of goods, services and labour,
- Changes in settlement patterns for homes, expanding services to new areas,
- Evolving service levels, including the introduction of new services and assets, and,
- Patterns in technology, lifestyle and public expectations.

Capital

Capital Assets are critical to providing services. Most services imply utilization of capital assets such as vehicles (police cars, fire truck, transit buses, works equipment), buildings (recreation renters, rinks, libraries, depots) and parks to linear assets such as bike-lanes, roads, sidewalk and active transportation networks. As of March 31, 2020, these assets have a book value of $3.8 billion.

The stewardship of capital assets has significant financial consequences. Assets are acquired through HRM's capital budget and funded through several means including debt issuance, reserve funds, capital from operating (transferred from the operating budget) or cost-sharing through intergovernmental infrastructure programs. Total capital costs are broader than acquisition costs. Assets need to be operated which requires additional costs. For example, transit buses require drivers to operate them and fuel to run them. Buildings have utility costs and staff. Assets also require ongoing maintenance and upkeep and, eventually, must be replaced. Together these costs are known as life-cycle costs. Experience indicates operating components often cost more than the initial acquisition costs.

Reserves

Reserves are an important tool for municipalities. Reserves are funds that are earmarked for future purposes. Certain reserves are required by legislation and can have restrictions on their use. Reserve contributions come from operating funds or from the sale of assets such as surplus land or business park parcels.

Used properly, reserves support long-term planning and enhance financial sustainability. Reserves require careful thought and must be tied to very clear, defined needs. If reserve levels are too high, it essentially means that citizens have been over-taxed and that funds are sitting idle, not being utilized. Likewise, if balances are too low, the municipality may have insufficient funds to be sustainable over time.

Debt

As a rule, low debt levels could mean deferred maintenance costs are growing or HRM is missing out on major investment opportunities. Conversely, debt levels that are too high place excessive pressure on tax rates. Operating budget impacts of debt are directly related to debt servicing costs, that is principal and interest. Due to historically low interest rates, HRM long-term investment costs are much lower than in the last 30 years. Provincial guidance is that debt charges should represent no more than 15 per cent of total revenues. HRM's has $44.5 million of total debt charges in the 2020/21 operating budget, which represents 4.7 per cent of total expenditures and 5.7 per cent of municipal expenditures. Tax supported debt charges are $35 million, or 3.7 per cent of total expenditures.

This represents a significant decline in the historical trend and suggests that HRM has significant capacity to increase its stock of debt. As of 2020 HRM has approved or outstanding debt of $235.7 million.

<u>Recommendations for Sustainability</u>

HRM's current financial strategies and tools have served it well as it has grown over the past 25 years. At the time it was formed HRM quickly became a high debt municipality that struggled with the ensuing population growth and its expanding service areas. The creation of Master Plans, the Regional Plan, and its Multi-year Financial Strategy served it well over most of this time. The municipality has seen steady consistent decline in its debt levels as well as higher capital budgets and improved services through steady, measured growth. The range of financial tools it had, allowed a level of fiscal sustainability that served it well over most of this time period. In the past several years, however, several key factors have shifted for HRM.

- HRM has entered a new phase of economic growth. The growth in its population and economy has become much more rapid. Prior to the pandemic, HRM was one of the fastest growing cities in the country. This growth brings significant opportunities as the city expands and attracts many newcomers, including immigrants. There is every reason to believe the end of the pandemic will see this trend continue, and possibly even strengthen, and that new opportunities will arise. At the same time, however, this rapid growth is also bringing challenges. Along with the growth comes higher costs for governments and individuals as well as issues of affordability, accessibility and inclusion.

- At the same time, perhaps because of that economic growth, there has been a sharp increase in public expectations. Residents are demanding more services such as increased bike lanes, recreation facilities, access to active transportation corridors, green space as well as increased protective services such as fire services.

- In response to HRM's place as a regional hub and one of Canada's major regions, Regional Council has approved several key city building initiatives. Major initiatives such as the Integrated Mobility Plan (IMP), HalifACT and the Rapid Transit Strategy are typical of the changes underway in HRM. Initiatives such as these require leadership to proceed but their success is heavily dependent upon strong, long term planning, robust funding models and significant new sources of revenues. More and more HRM finds itself approving such long-term strategic projects without a clear sense of the overall long-term financial picture, how such initiatives will be funded, or what the various alternatives and opportunity costs are. As such, projects such as these are at risk of failure.

Based on these changes in the environment, HRM is at risk of falling behind in fiscal sustainability. It is critical to remember that fiscal sustainability does not mean either a high or low level of funding. Rather it requires future funding and expenses to be predictable, planned out and consciously decided upon. As such, HRM should be able to scale its operations to meet varying levels of long-term sustainability. Therefore, this report recommends three chief changes to its current policies:

1. First, there is a strong need for robust, long-term planning. HRM needs to strengthen long-term financial analyses related to the day-today decisions it makes. This will allow it to understand, plan and execute its strategic projects and its long-term financial picture. Council will be asked to approve discontinuing the detailed Year 2 Budget.The detailed budgeting by business unit has proven to be enormous work and staff believe that focusing on a one-year budget and three-year fiscal outlook will be of greater strategic value. It is therefore recommended that the CAO be directed:

   - **Starting with the 2021/22 budget, and replacing the two-year detailed budget, develop a long-term Financial Plan, focused on sustainability, that includes a one-year Budget, a three-year outlook and a long-term plan based on Council's Strategic Vision that supports the operating, capital and reserve budgets and allows the Municipality to meet its long-term goals.**

2. HRM needs much more flexibility on its funding targets including debt and taxes. It needs to understand its long-term revenues options for fees versus taxes and the level of each that the economy can support. This includes impacts on competitiveness, accountability, transparency, services, administrative costs as well as impacts on low-income residents. It is therefore recommended that the CAO:

   - **For the 2022/23 budget, provide a Tax and Fee Revenue Strategy to Budget Committee that will establish guiding principles for user fees and property taxes.**

3. Lastly, HRM needs to provide clarity in funding its strategic projects. Existing budget systems are not set up to provide the type of extensive funding to allow large strategic projects such as IMP, HalifACT and Rapid Transit to be successfully completed on time. Therefore, it is recommended that Budget Committee direct the CAO to:

   - **For the 2021/22 Budget, develop "Strategic Initiative" Reserves for projects that are tied to an approved Council strategy and are significant enough to lead to a discernable increase in the tax rate or special funding that is outside the normal budget process. This should include any required changes to debt and reserve policies and should be eligible to be funded through dedicated tax levies.**

If agreeable with Regional Council, during the 2021/22 budget debate, the CAO and CFO will present proposed Strategic Initiative Reserve Funds, detailing the costs involved, the various alternatives and options, and the impacts on debt and tax levels. It will be the ultimate decision of Regional Council to approve any new strategic fund.

Other Actions

The Fiscal Sustainability Action Plan (Attachment 2) identifies planned implementation of new strategies and processes. These are closely linked to either existing work or the above Council recommendations. They include:

- Service-based budgeting will lead to new perspective on the municipality. The intent is that the municipality will budget and report, not by business unit, but by service. This requires major changes in costing and reporting and can only be done with the introduction of the new SAP financial system. This initiative is expected to start in fiscal 2023/24. It will require additional outside resources and will likely take at least two years to complete. We will be back to Regional Council at a date to be determined for a decision related to service-based budgeting.

- Commencing in 2022/23, long-term capital planning will identify the on-going maintenance and replacement costs for assets currently used to deliver municipal programs, e.g. roads, buses, libraries and sports fields, as well as capital required for new and evolving services for a growing Halifax region.

- Commencing in 2021/22, long-term reserve planning will include specific annual and long-term targets and uses for reserves. These targets shall align with mid and long-term financial plans, reflect risk factors and support municipal goals and future opportunities.

- Commencing in 2021/22, long-term debt planning will make debt funding available for growing infrastructure needs; HRM will review its debt targets and set a level appropriate for the Municipality's current growth and economic trajectory.

- Commencing in 2022/23, HRM will update the work it has done on settlement patterns, so it can better understand current and future costs and revenues, as they relate to built form and specific areas of the growing municipality.

- Actively seek other financing opportunities outside of the NSMFC, such as the FCM Green Fund and the Canada Infrastructure Bank. This will require approval from the provincial government either through amendments to the HRM Charter or a broadening of the Nova Scotia Municipal Finance Corporation Act.

In reviewing the changes and future actions in policies and practices that can be undertaken, staff recognized that many of these actions are the regular work of staff, are underway and/or are the focus of ongoing improvements. In the Action Plan (Attachment 2), it categorized such actions as improvements to existing processes. These range from improvements in financial reporting (e.g. Financial Implications sections of council reports) and cash flow analysis, to reviewing the residential/commercial tax split. Work is ongoing in many of these areas and can continue without additional Council approval.

FINANCIAL IMPLICATIONS

The Fiscal Sustainability Strategy outlines needed adjustments to policies that must be changed. Any specific financial changes will occur during the 2021/22 budget debate. To move several initiatives forward it is anticipated that there will be a requirement for additional FTEs, consulting services as well the potential costs of developing a long-term financial model.

RISK CONSIDERATION

The medium-term risks to not adopting this strategy are concrete. Transformational and city-building initiatives will be harder to plan and implement without a fiscal framework to do so. Incremental progress through appropriations in the annual budget process is insufficient to address major Regional Council priorities beyond the immediate.

COMMUNITY ENGAGEMENT

Citizens have an opportunity to provide feedback on the budget through a citizen survey through the Shape Your City portal.

ENVIRONMENTAL IMPLICATIONS

There are no environmental implications.

ALTERNATIVES

Budget Committee may decide to reject or modify any of the recommendations.

ATTACHMENTS

Attachment 1: Fiscal Sustainability Strategy
Attachment 2: Fiscal Sustainability Strategy – Future Actions

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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

FISCAL SUSTAINABILITY STRATEGY

December 15, 2020

Halifax Regional Municipality

Outline

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Introduction

As the Halifax Regional Municipality approaches a population level of 500,000 people, it faces a set of different challenges from the past. In the 25 years since the municipality was established, the region has grown from the largest population base in Atlantic Canada, to a major Census Metropolitan Area (CMA) in Canada and, with it, greater economic and cultural heft.

The municipal government (HRM) operates under a legislative framework derived from the Municipal Government Act (MGA). HRM has its own charter which differs in some important ways from the MGA. Due to the prescriptive nature (non-permissive) of these Provincial Acts, HRM's revenue generation is limited to the property tax and some limited fees related to cost-recovery of services and infrastructure.

Unlike other orders of government, HRM's borrowing capability is limited to debentures, through the Nova Scotia Municipal Finance Corporation (NSMFC) and subject to Ministerial approval. Borrowing through the NSMFC is permitted for capital asset purchases only while the term and structure of financing is predetermined by provincial rules.

HRM cannot legally run a deficit in consecutive years and must operate conservatively, matching current expenditures to revenues, rather than the dynamic manner that federal and provincial levels can operate at.

The municipality has entered a new phase of economic growth. The growth in its population and economy has become much more rapid. Prior to the pandemic, the Halifax Regional Municipality was one of the fastest growing jurisdictions in the country. The Halifax region is much richer on a per-capita basis than in 1996 and its financial position has improved markedly. This growth brings significant opportunities as the municipality expands and attracts many newcomers, including immigrants. There is every reason to believe the end of the pandemic will see this trend continue, and possibly even strengthen, and that new opportunities will arise.

At the same time, this rapid growth brings challenges. Along with growth comes higher costs for governments and individuals as well as issues of affordability and inclusion, to ensure that all benefit in the growth that the Halifax region is experiencing. Perhaps because of that economic growth, there has been a sharp increase in public expectations for more services and amenities. Council has adopted a number of important, ambitious strategies in response to the public and Halifax's prominence as a regional hub and one of Canada's *Big Cities*. New major initiatives such as the Integrated Mobility Plan (IMP), HalifACT and the Rapid Transit Strategy are some of the changes underway in the region. More and more, HRM finds itself approving long-term strategies without a clear sense of the overall long-term financial picture, how such initiatives will be funded, or what the various alternatives and opportunity costs are. Projects such as these put increasing pressure on existing services and, without a clear financial plan, the initiatives themselves are at risk of failure.

This document will focus on the following:

- Current financial state
- Review of existing financial policies and practices
- Outline key policy changes required to ensure long-term fiscal sustainability

The Fiscal Sustainability Strategy will lay the foundation to achieve long-term goals of the community and safeguard the future. It builds upon HRM's post-amalgamation "Multi-Year Financial Strategy" (1999), a significant document that set the financial policy for HRM, enshrining financial stability and reducing corporate debt over the past 20 years.

Current Financial State

Overview of Four Financial Levers

Municipal financial management can occur in one of four areas. These four financial "levers" are: (1) Operating and Taxes, (2) Capital, (3) Reserves and (4) Debt. These areas are closely interrelated and each effects the other.

- **Operating and Taxes** – The operating budget sets out the cost of running the municipality. The budget includes the cost to provide services such as salaries and benefits, fuel, commodities, contracting, consulting, and general office expenses. These costs are offset by municipal revenues, such as user fees, fines and transit fares. The largest revenue source is property taxes, which represents nearly 82 per cent of total revenues.

- **Capital** – The capital budget is an expenditure plan for investment in long-term assets, such as buildings, parks, streets and roads or technology.

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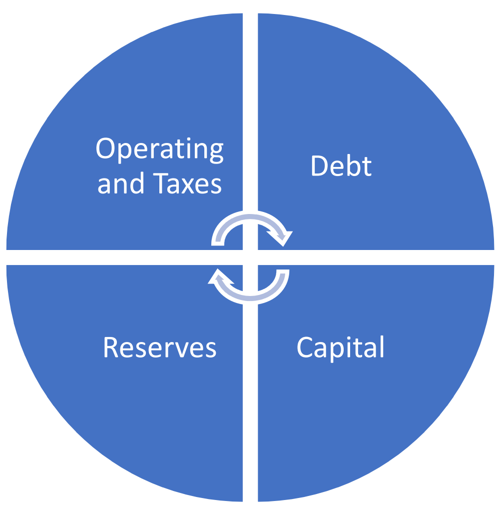
- **Debt** – HRM may borrow (issues debentures) for the purchase of its long-term capital assets. All debentures are issued through the Nova Scotia Municipal Finance Corporation (NSMFC), a provincial agency.

Figure 1 – The Four Financial Levers



Relationship between Households (HH) and Government

It may be helpful to view these levers in the context of a household structure. Operating costs are similar to the day-to-day costs most individuals have such as groceries, fuel and utility costs (e.g. heat, power and lights). Salaries or other household revenues are used to pay those costs. Households use debt such as mortgages, auto loans or lines of credit. Long-term savings in a TFSA or RRSP for future expenditures resemble reserve holdings. The family home is similar to the capital assets held by a municipality.

Importantly, government and households differ in substantial ways. Households earn or save for consumption of private goods, while governments produce public goods. Public goods differ from private goods in that they must be available to all. The scale, scope and complexity of operations for government is obviously much greater than in a household. Moreover, the provision of those services can indirectly enable economic growth. These distinctions give government a unique role in society through its provision of public services and public infrastructure.

Current State, Operating and Taxes

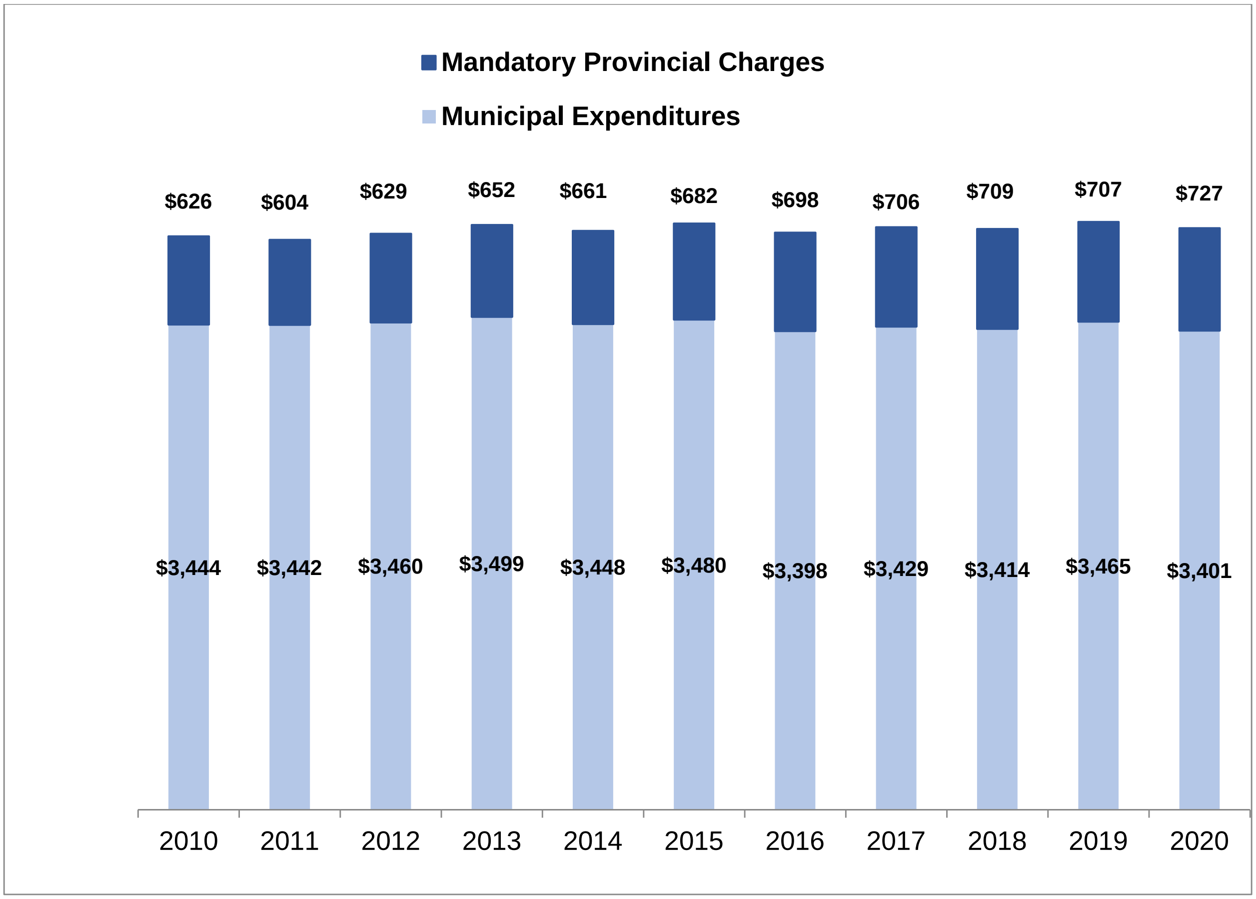
In June 2020/21 HRM approved a $955.5 million operating budget. Significant costs included compensation ($405.4 million), mandatory provincial costs ($168.2 million), external services including RCMP ($121.5 million). Also included were a net reserve contribution of $23.1 million, $44.5 million in payments for debt costs; $19.8 million in transfers to the capital budget and $2.7 million budgeted to cover the operating costs of new assets.

Total HRM costs (less provincial mandatory costs) were $787.3 million in 2020/21, known as Total Municipal Expenditures (the “Municipal Budget”), which represents the costs to fund municipal services. HRM costs are influenced by several factors:

- Growth in the population, number of homes and businesses
- Economic factors, including inflation and the costs of goods, services and labour
- Changes in settlement patterns for homes, expanding services to new areas
- Evolving service levels, including the introduction of new services and assets
- Patterns in technology, lifestyle and public expectations

Figure 2 (below) shows that the cost of municipal services per dwelling, adjusted for inflation, has not increased over the past 10 years. In other words, Total Municipal Expenditures have kept up to both the rising cost to provide municipal services (15 per cent over the past 10 years) and the rising demand for municipal services from new homes (12 per cent or 22,000 additional dwellings) but have not exceeded them. Including mandatory provincial costs, the average annual increase not accounted for by inflation or growth is just 0.1 per cent. This history of measured expenditure growth sets up the municipality to make future financial decisions from a very stable foundation.

Figure 2 – Real Expenditures Per Dwelling Unit: 2010-2020



Current State, Operating and Taxes (Continued)

Taxation and other revenues pay for municipal services. Property taxation (including Payments in Lieu of Taxes from senior levels of government) makes up more than 80 per cent of revenues. Other revenues include deed transfer taxes, transit fares and interest revenues. Property taxes are viewed as highly predictable and a stable source of revenues for municipalities.

HRM levies property taxes on the value of properties. Nova Scotia's assessment system is administered by the Property Valuation Services Corporation (PVSC), an independent agency. The underlying assumption of the assessment system is that property values are a proxy for property owners' ability to pay. HRM levies three general tax rates – Urban, Suburban and Rural – which fund most municipal services. It also levies two transit taxes: a local transit tax for local transit service and a regional transit tax. A 1.5 per cent deed transfer tax rate is levied on the sale of properties.

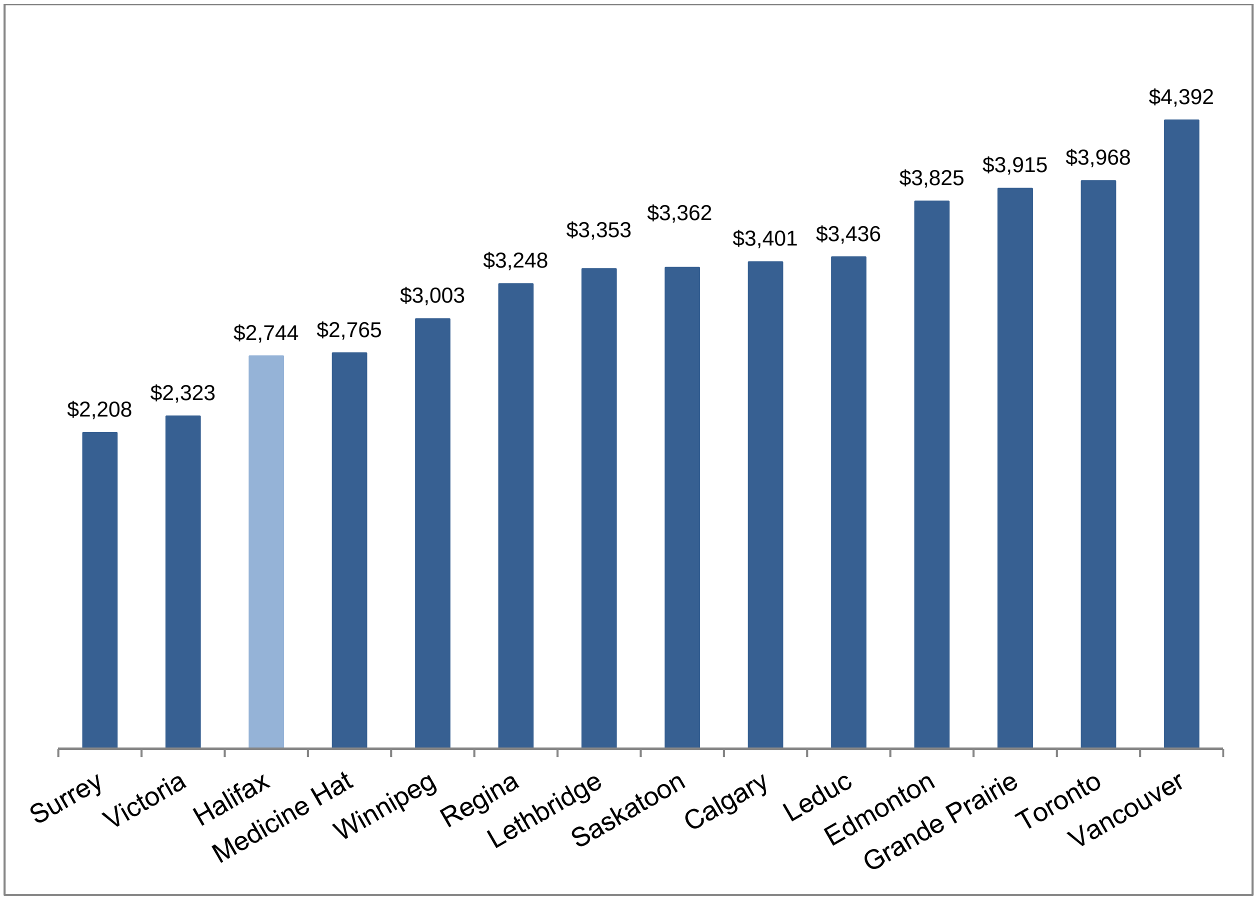
Key facts about the property tax:

- HRM is heavily dependent on property tax with limited use of user fees. Property tax is collected twice per year. The interim tax bill is due April 30 and a final tax bill due October 30.
- Residential Property Tax makes up 62 per cent of property taxes collected while Commercial tax is at 38 per cent. On average, residential property tax amounts to 2.9 per cent of household income, while commercial tax represents about 1.3 per cent of nominal GDP (gross domestic product).

- The commercial tax rate is 2.7 times the residential tax rate. Across Canada, commercial tax rates are typically higher than residential tax rates. Research in Halifax suggests that on average, commercial taxpayers pay more in taxes than they obtain in services while most residents obtain more in services than they pay in taxes.
- The provincially legislated Capped Assessment Program (CAP) limits the growth in residential assessment to growth in the Consumer Price Index (i.e. inflation). While this provides short-term stability for owners of single-family homes, it also creates inconsistencies amongst homeowners and disadvantages – through affordability issues – for those with apartments, new homes and homes recently sold.
- Development charges are used in master plan areas and as regional development charges, to recover the costs of new growth-related infrastructure.
- Area Rates are allowed for local community organizations and for private roads. In addition, Local Improvement Charges (LICs) are permitted.
- HRM offers low income property tax deductions and deferrals.

One of the guiding principles of taxation is competitiveness. In order to measure this, HRM participates in an annual survey of property taxes carried out by the City of Calgary. Two charts from that study are provided below. Figure 3 shows the average tax on single-family homes and Figure 4 shows the total taxes (residential, resource and commercial) collected by select municipalities divided by the population. These benchmarks consistently indicate the Halifax region is at the lower end of property tax burdens, although qualifications are useful. Namely, there can be considerable variation for individual homes, given the range of housing and the impact of the Capped Assessment Program. As well, services provided by municipalities can differ significantly by province and city size (e.g. subways in Toronto).

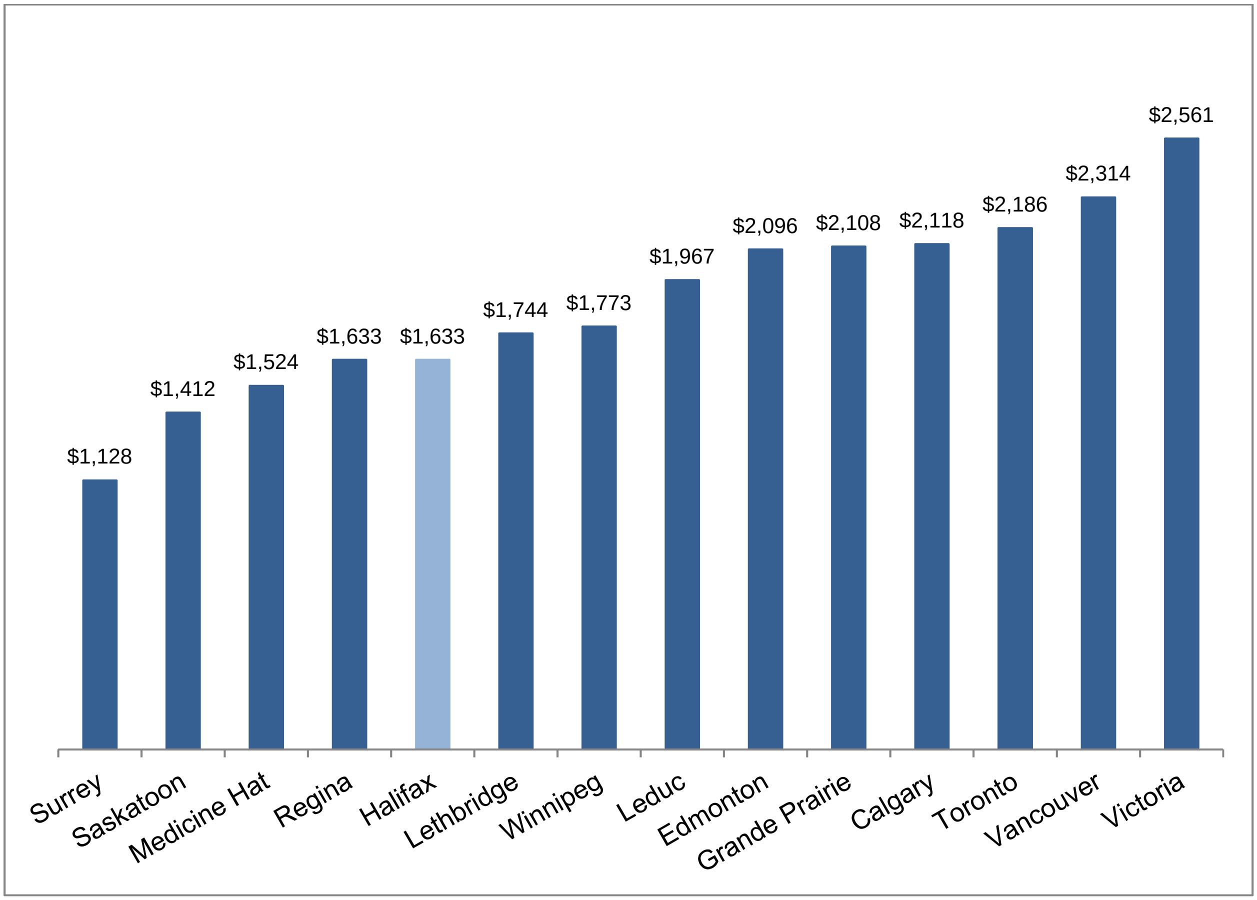
Figure 3– Average Tax per Single Family Home, Selected Municipalities



Source: 2018 Residential Property Taxes and Utility Charges Survey, City of Calgary

Source: 2018 Residential Property Taxes and Utility Charges Survey, City of Calgary

Figure 4 – Total Property and Business Tax Per Capita, Selected Municipalities



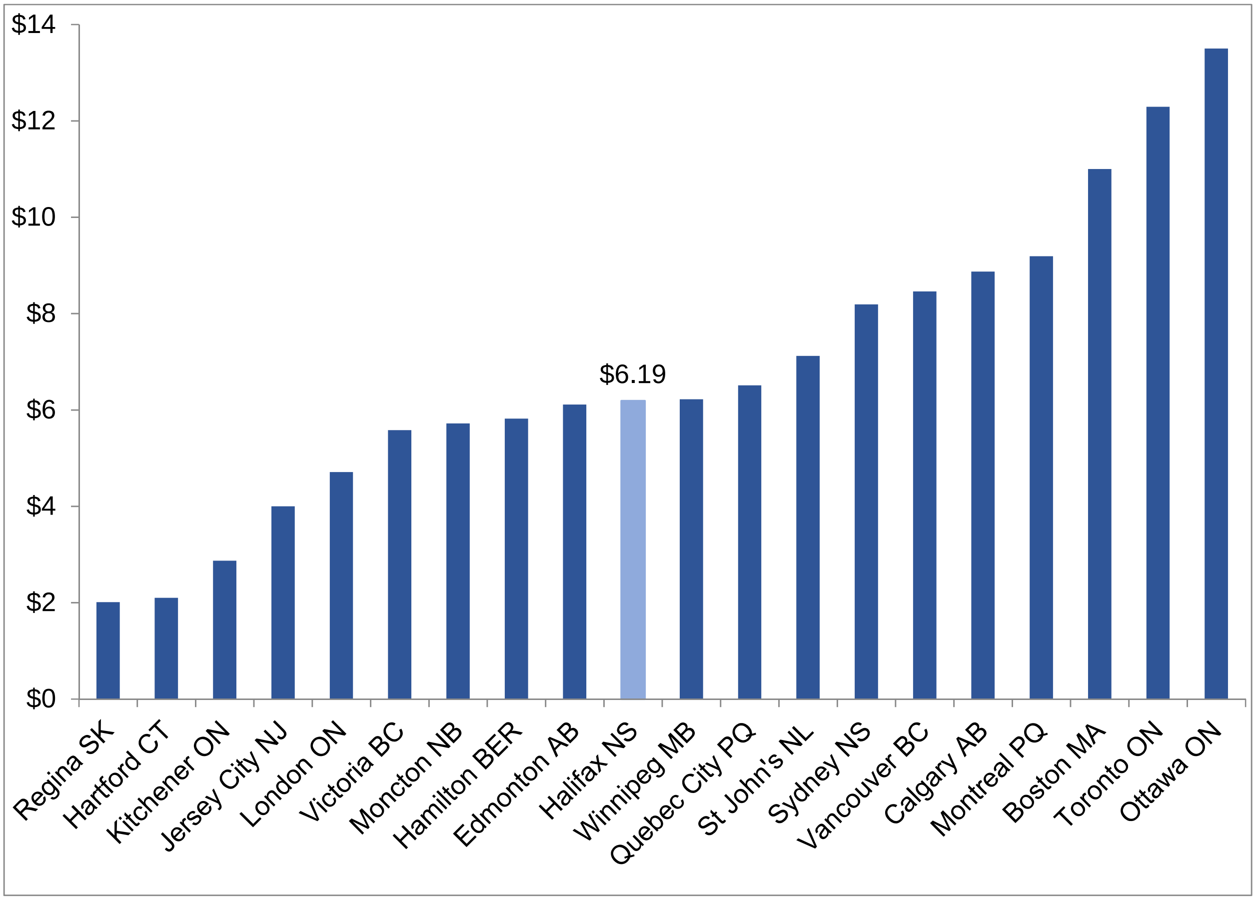
Source: 2018 Residential Property Taxes and Utility Charges Survey, City of Calgary

Commercial Property Tax

Commercial taxation is difficult to benchmark across the country due to variations in property prices and diversity in commercial sectors. Studies such as Altus's annual *Canadian Property Tax Rate Benchmark Report* look simply at tax rates and ignore variations in property values. Similar comments can be made of the CD Howe Institute report, *What Gets Measured Gets Managed: The Economic Burden of Business Property Taxes (2013)*[1]*.* To obtain a better picture of inter-city competitiveness, in 2010 and 2015, HRM contracted Altus Group to benchmark commercial taxation per square foot. Different building types were compared in three key sectors of the commercial property market. The results have shown Halifax benchmarks at a moderate level of commercial taxation for office towers and higher taxes for industrial properties. This is shown in Figures 5 to 7 for Class A office space, Class B office space and industrial properties. Currently, these benchmarks are being updated and will be publicly available in early 2021.

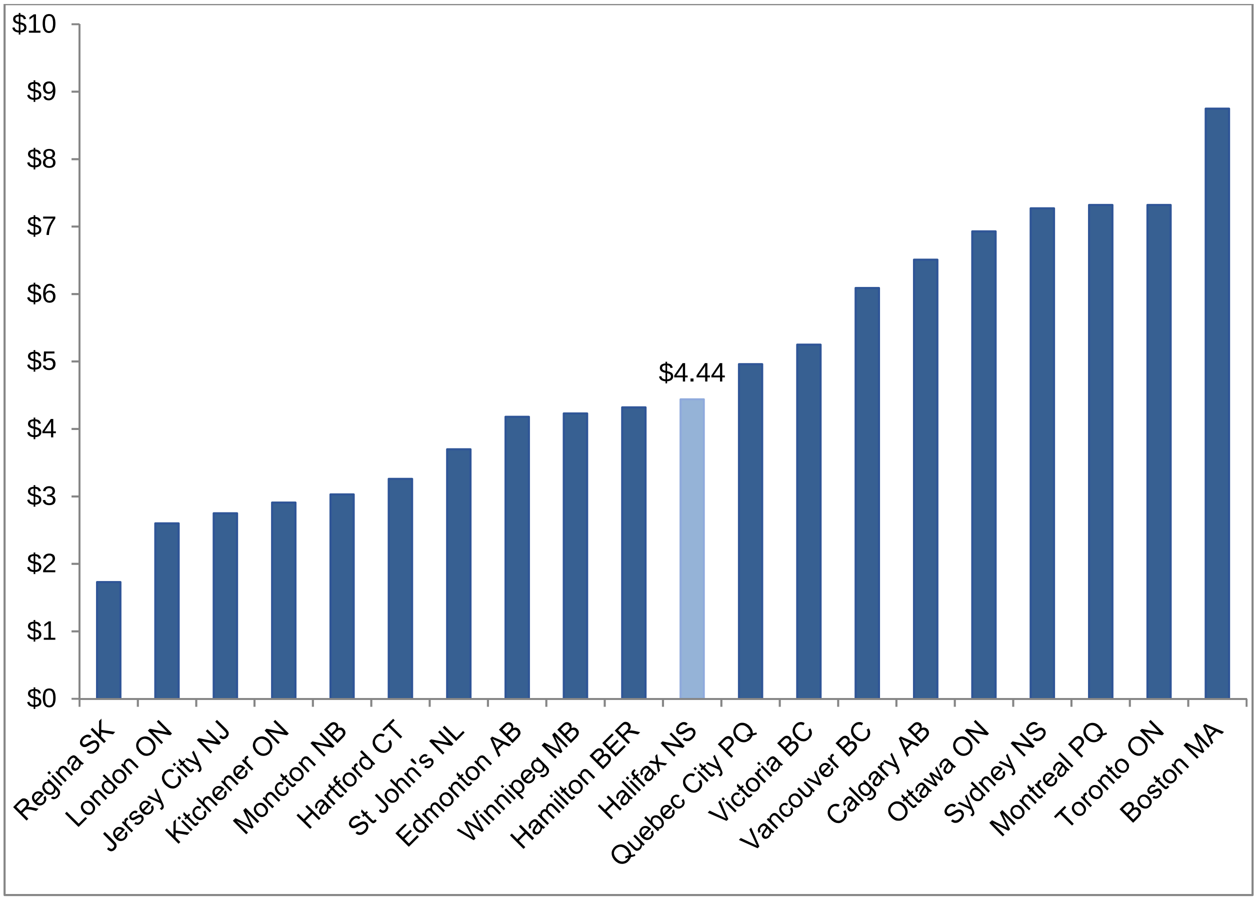
[1] https://www.cdhowe.org/public-policy-research/what-gets-measured-gets-managed-economic-burden-business-property-taxes

Figure 5 – Average Annual Property Taxes Per Square Foot, Class A Office Space (2015)



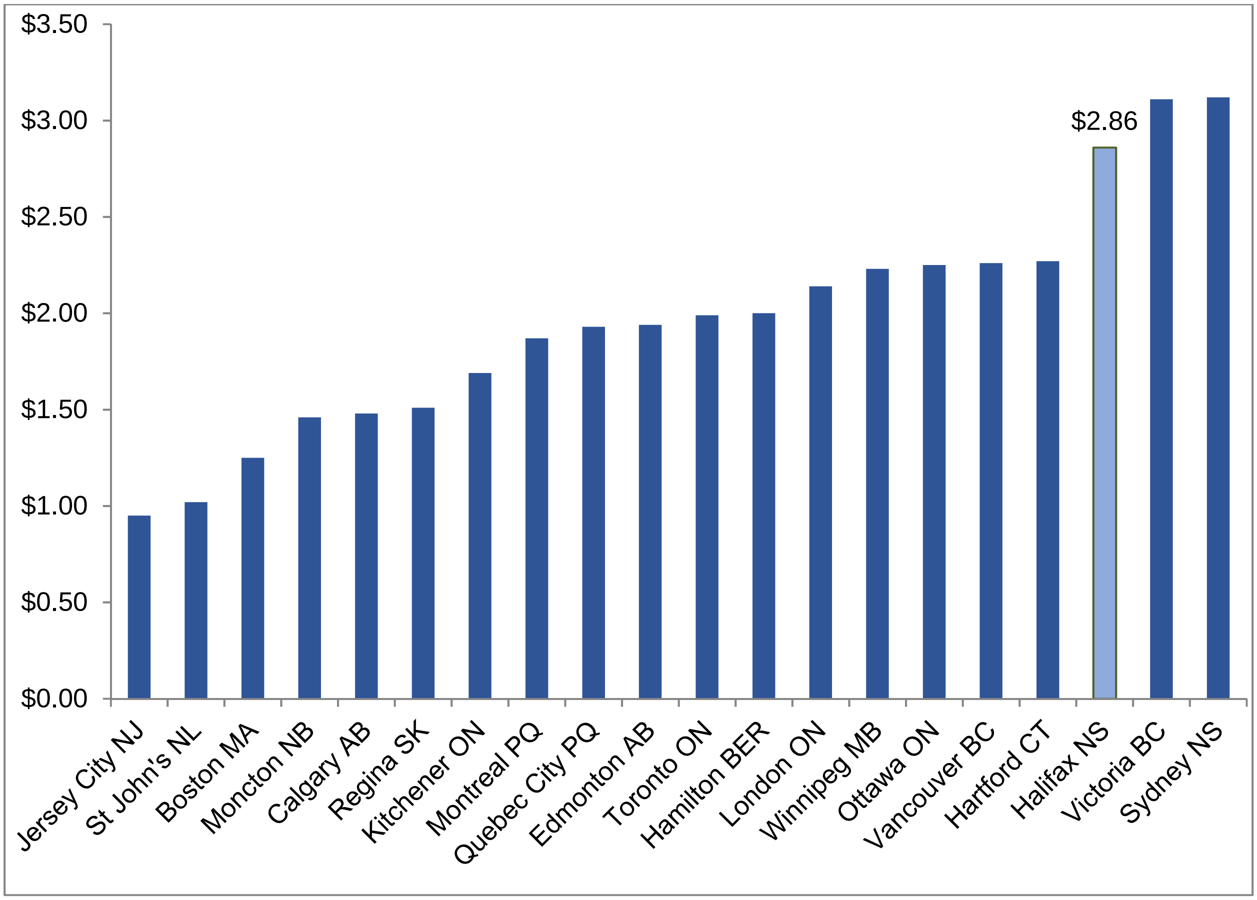
Source: Altus Group Study for HRM, 2015

Figure 6 – Average Annual Property Taxes Per Square Foot, Class B Office Space (2015)



Source: Altus Group Study for HRM, 2015

Figure 7 – Average Annual Property Taxes Per Square Foot, Industrial Space (2015)



Source: Altus Group Study for HRM, 2015

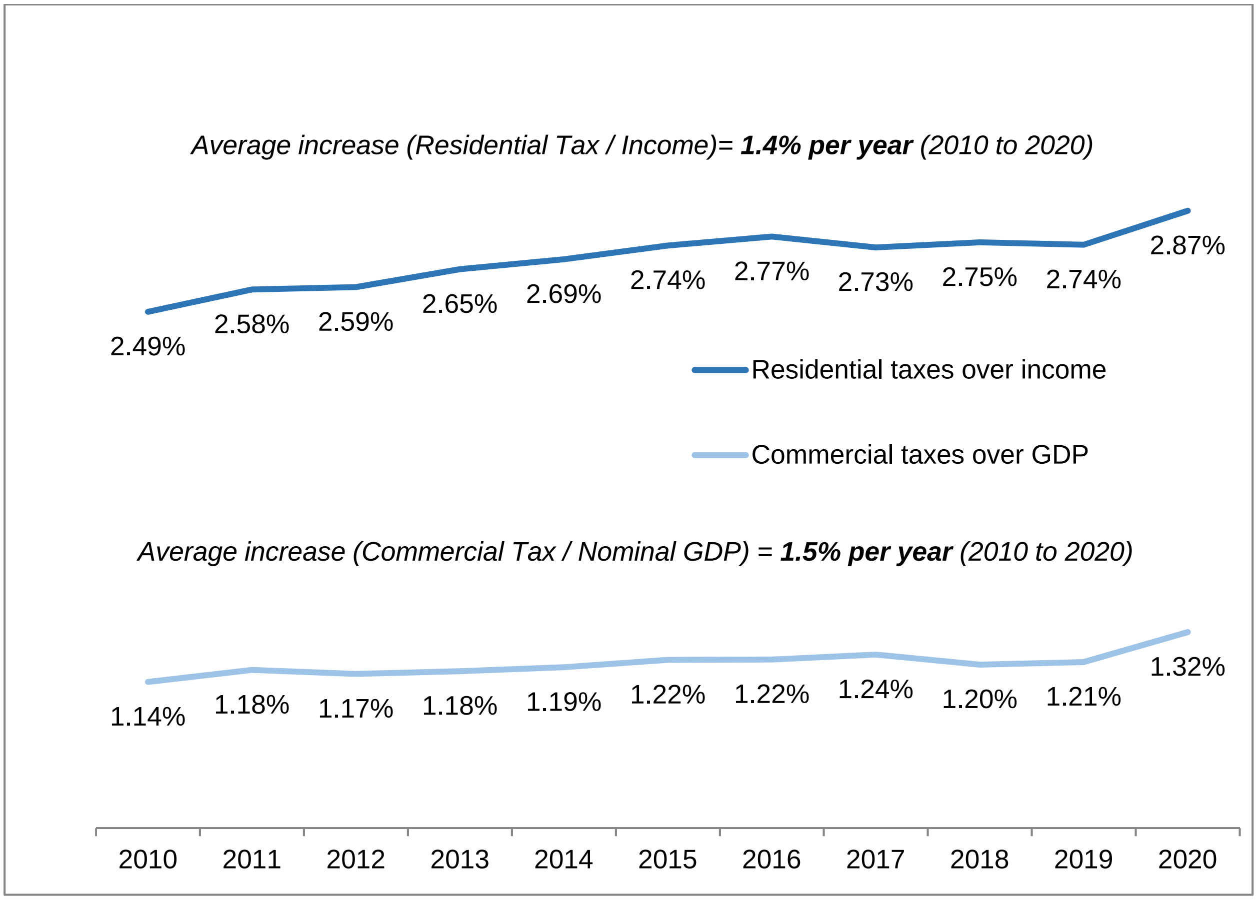
Relative Comparisons, Economic Variables and HRM Metrics

Fiscal sustainability is greatly influenced by the strength of, and variations in, the regional economy. The municipality has an impact on that same economy: municipal spending supports demand for goods and services, the capital budget supports the construction industry, while property taxes demand a portion of consumer spending and business fixed costs. Figure 8 below illustrates HRM's impact, using macro variables to estimate burdens and impacts. Both research and theory indicate that HRM budget spending supports economic demand through employment of FTEs and its capital plan, largely carried out by the private market. Property taxes benchmark favorably relative to macro variables.

HRM follows the tax and economic trend data closely. Key indicators are residential tax revenues relative to personal income and commercial tax revenues relative to GDP. HRM has undertaken specific studies on aspects of commercial taxation. "*Study of Commercial Taxes as a Driver for Business Location Decisions" (April 2012)*[2] looked at location factors for why firms located within specific areas of HRM. Canmac Economics have studied the economic impact of property taxation on small firms and concluded that in aggregate commercial taxes have limited influence on investment decisions at the macro level. ("*An Economic Analysis of the Halifax Regional Municipality Commercial Tax*", Canmac Economics, December 2017)[3]. Nonetheless, individual business decisions may be impacted by the level of tax on a case by case basis.

[2] https://www.halifax.ca/sites/default/files/documents/home-property/property-taxes/BusinessLocationStudyAltus.pdf
[3] https://www.halifax.ca/sites/default/files/documents/home-property/property-taxes/CanMac_Commercial_Tax_January_2018.pdf

Figure 8 – Commercial Tax Relative to GDP, Residential Taxes Relative to Income



Source: Internal Estimates, Statistics Canada

Current State, Capital

Capital assets are critical to providing services. Most services require capital assets such as vehicles (police cars, fire truck, transit buses, works equipment), buildings (recreation centers, rinks, libraries, depots) and parks as well as linear assets such as bike lanes, roads, sidewalk and active transportation networks. As of March 31, 2020, these assets have a book value of $3.8 billion.

The stewardship of capital assets has significant financial consequences. Assets are acquired through HRM's capital budget and funded through a number of means including debt issuance, reserve funds, capital from operating (transferred from the operating budget) or cost-sharing through intergovernmental infrastructure programs. The total cost of capital assets is much broader than acquisition costs. Assets need to be operated. For example, transit buses require drivers to operate them and fuel to run them and buildings have utility costs and staff. Assets also require ongoing maintenance and upkeep and, eventually have to be replaced. The total cost for the life of the asset is known as life-cycle costs. Operating components often cost considerably more than the initial acquisition costs and are a key driver of costs.

Linear assets such as roads are tied closely to municipal planning efforts. Increasing outward growth leads to a greater need for linear assets with higher operating service costs. For example, snow plows and other vehicles have more kilometers to drive, there are more streetlights, a greater volume of roads to pave and potentially a need for more recreation centers, playgrounds and other amenities. Infill developments (on vacant land) and redevelopment of existing sites does not produce the same infrastructure demand. Multi-unit dwellings, such as apartments and condos, are typically more efficient to service than single-family homes.

Where and how the municipality grows has a significant impact on the cost of infrastructure and services, especially those that connect people and places across the municipality. For that reason, HRM developed and approved the Regional Plan[4] in 2006 and continues to update it. This plan for current and future growth ensures that the region can continue to develop in a way that allows services to be provided where needed in an affordable way.

While capital assets are approved through the capital budget, they have a clear and powerful impact on the operating budget and the tax rate. It is taxes that primarily fund the acquisition of assets (through debt repayment, reserve contributions and capital from operating) and it is taxes that fully fund the operating, repair and maintenance costs. Hence, while such assets are acquired through the capital budget, they have a powerful impact on current and future operating costs.

Funding and Capacity Gaps

HRM's capital processes suffer from two gaps. First, there is a funding gap defined as the difference between the cost of all desired projects and the available funding. HRM has more than 100 strategic plans and documents, many of which identify aspirational capital items. However, many of these plans do not have associated funding plans. The large stock of existing assets requires constant preventative maintenance coupled with upgrades. This means that HRM desires more capital funding than it can provide with its current tax revenue. Regional Council has approved a commitment of 70-80 per cent capital funding to rehabilitating existing assets. While such "asset renewal" is critical to maintaining assets and keeping costs under control, it is also very low key, with many citizens unaware it is happening. Often times it is the newer "growth" related assets and services that capture public attention.

Second, a capacity gap exists. This is defined as the difference between the resources and systems needed to quickly complete the desired work and the current ability to complete such work. While HRM's capital budget since 2013 has ranged from $130 million to nearly $200 million, a considerable number of these capital projects are yet to be completed. Although this is partially due to staffing capacity, many capital projects take significant time to implement and complete. Purchasing land often requires detailed negotiations, characterized by uncertainty. Community consultation can be a significant part of large projects. Many capital items have considerable design or purchasing lead times. Sophisticated capital planning and diligent project management are fundamental to shrinking the funding and capacity gaps.

As a result of the funding and capacity gaps, a variety of issues tend to compound. Capital planning tends to focus on shovel-ready projects – making it more difficult to concentrate on a cohesive long-term plan or to advance longer term strategies. In turn, this tends to encourage a loss of focus and a reactive approach; insufficient funds are available for preventative maintenance, meaning repair issues become more costly, creating even greater funding issues. According to the American Society of Civil Engineers (ASCE), preventative maintenance is 4-6 times cheaper than reactive maintenance.

Given this importance, HRM's Enterprise Asset Management (EAM) is designed to track and standardize asset metrics so that asset condition can be analyzed by asset class and repair requirements. Actual capital spending per year is a rough measure of HRM's current capacity to deliver capital projects.

Current State, Reserves

Reserves are an important tool for municipalities. Reserves are a funds set aside for future purposes. Certain reserves are required by legislation and have set restrictions. Reserve contributions come from operating funds or from the sale of assets such as surplus land or the sale of business park parcels.

[4] http://legacycontent.halifax.ca/council/agendasc/documents/8-1-iiRegionalMunicipal.pdf

Reserves may be used for operating or capital purposes. Withdrawals must be authorized by Council, either through the budget process or by resolution (via the Audit and Finance Standing Committee).

Used properly, reserves support long-term planning and enhance financial sustainability by allowing unexpected or large expenditures to occur without significant impact to other services or tax rates. Careful planning is necessary so that reserve balances remain appropriate. Insufficient reserve balances may suggest unsustainable expenditure trends and/or forecast lack of resilience when external impacts hit. For example, reserves earmarked for major projects that do not accrue revenue at the rate required to fund the reserve portion of the project.

HRM has 21 reserve accounts. Projected balances are show in Figure 10. These balances are shown net of all Council commitments that have been made, even though these commitments have not yet been paid out. As reserves are future oriented, commitments exist not just for the current year but for future years.

Figure 10– Projected Balances in Reserves after Commitments

	2020/21	2021/22	2022/23	2023/24
Reserve Balances	$207,196,707	$190,057,974	$131,992,945	$125,797,492

Current, 2020/21 Reserve Budget, Projected Balance as of end of the Fiscal Year

HRM classifies its reserves into three categories, each of which aligns with the one of the three purposes for reserve funds:

- **Risk Reserves** are where funds are held as contingency, to be used to mitigate unforeseen events. An example would be the insurance reserve.
- **Obligation Reserves** are where funds are set aside for an expected future event. Often there are annual contributions so amounts can accumulate. An example would be the Landfill Closure Reserve. This reserve is required under accounting standards and the funds are to be used to deal with the future environmental costs of closing the current landfill.
- **Opportunity Reserves** are where funds are set aside so that the HRM can quickly fund an unexpected opportunity. For example, time-constrained cost-sharing opportunities with other orders of government.

Several benchmarks for reserves exist as part of the Province of Nova Scotia's Financial Condition Indicators (FCI).

- The Operating Reserve FCI recommends that operating reserve balances be at least 20 per cent of operating expenses. HRM has 14 per cent.
- The Combined Reserve FCI suggests that total capital and operating reserve balances be at least 40 per cent of operating expenses and amortization expenses. HRM is at 26.3 per cent.
- In addition, the Government Finance Officers Associations (GFOA) recommends reserves equal to two months of operations, which translates into 16.7%.

Finance staff consider these thresholds to be less instructive in the context of HRM's financial position. If HRM were to hold the required 40 per cent as per FCI guidance, balances would be above 400 million in a given fiscal year. While broad indicators are useful guides, reserves require careful thought and must be tied to very clear, defined needs. If reserve levels are too high, it essentially means that citizens have been over-taxed and that funds are sitting idle, not being utilized. Likewise, if balances are too low, then the municipality may have insufficient funds to be sustainable over time. Rather than broad measures, reserves need to be tied into and reflect long-term operating and capital plans.

Current State, Debt

Debt is an important tool to fund the acquisition of major assets. It is an optimal financing tool for capital assets. It is important when looking at assets, that long-term revenues are matched to long-term assets. As a rule, low debt levels may mean deferred maintenance costs are growing or HRM is missing out on major investment opportunities. Conversely, high debt levels may make a municipality unsustainable.

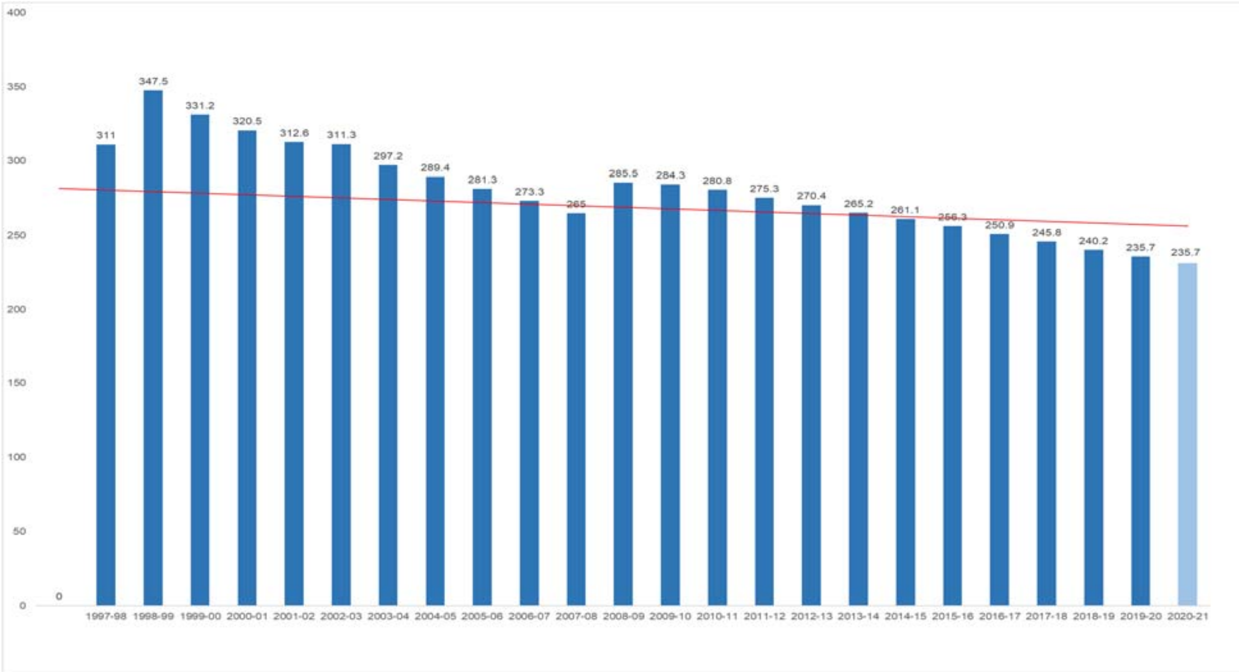
The operating budget impacts of debt are directly related to debt servicing costs, that is, principle and interest. Due to historically low interest rates, municipal long-term investment costs are much lower than in the last 30 years. Provincial guidance is that debt charges should represent no more than 15 per cent of total revenues. HRM has $44.5 million of total debt charges in the 2020/21 operating budget, which represents 4.7 per cent of total expenditures and 5.7 per cent of municipal expenditures. Its Tax Supported Debt Charges are $35 million, or 4.5 per cent of municipal expenditures. This represents a significant decline in the historical trend and suggests that HRM has significant capacity to increase debt for strategic investments.

As of 2020, HRM has approved or outstanding debt of $235.7 million, as detailed in the below graphic. HRM is required by provincial legislation to borrow its funds through the Nova Scotia Municipal Finance Corporation (NSMFC). Debt is guaranteed by the province, providing HRM with a lower interest rate than it could acquire through issuing its own debt. Debt is acquired once the asset is fully completed. HRM is able to borrow more than $80 million in 2021/22, pending approval from NSMFC.

HRM tracks total debt both as an aggregate and a per dwelling amount. Dwelling units are a major cost driver and an indicator of regional growth. Measuring costs or debt on a per dwelling unit basis is a useful comparison. It also allows debt metrics to be compared to property taxes, which are levied on a per property basis. In 2020, HRM has debt outstanding equal to $1,173 per home.

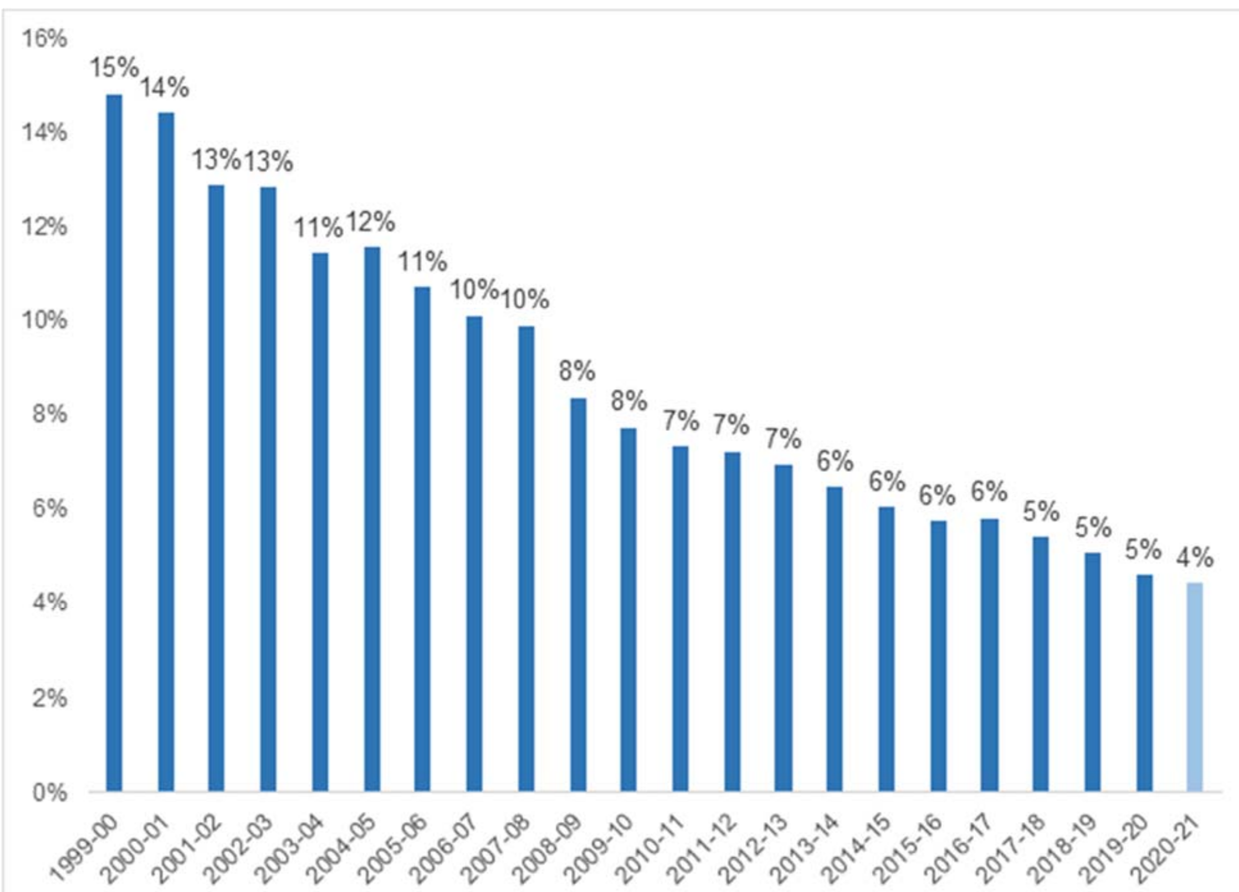
HRM primarily has Tax Supported Debt, which must be repaid through property tax or other revenues. Non-tax supported debt is repaid through dedicated revenue sources, such as debt that HRM has borrowed on behalf of Halifax Water (HW) and will be repaid from HW revenues or a local improvement charge that is repaid by benefiting property owners.

Figure 11– Trend HRM Tax Supported Debt, 1995-2020



Source: HRM

Figure 12– Trend HRM Debt Service Costs, 1999-2020



Source: Tax Supported Debt/Municipal Expenditures, HRM

Policy Framework and Recommendations

Policy Framework: Operating and Taxes

HRM has broad principles related to operating budget and taxes:

- Equity – providing reasonably similar levels of service irrespective of resources

Competitiveness – a tax burden that does not unduly impede business investment or sentiment

- Transparency – the comprehensiveness, clarity, reliability, timeliness, and relevance of public reporting on the past, present, and future state of municipal finances

Policies that support these principles:

- Through a series of Council decisions, HRM has established a tax structure that includes Urban, Suburban and Rural tax rates and separate transit tax rates. For example, sidewalks are funded through the Urban residential tax rate, while Suburban and Rural areas fund sidewalks through separate area rates or local improvement charges. Changes in tax structure are considered through Regional Council's "Area Rate Framework[5]".

- HRM supports low income individuals through formal tax rebate and tax deferral programs. These are found in the *Partial Tax Exemption Administrative Order* (Administrative Order Number Ten)[6] and the *Tax Deferral By-law* (By-law T-700)[7].

- Tax relief for Non-Profits and Charities is enabled through the *Tax Relief for Non-Profit Organizations Administrative Order* (2014-001-ADM)[8].

- Regional Council has expressed concern with the "unintended consequences" of the Assessment Cap (October 31, 2017)[9] and with taxation levels of small business (November 10, 2015)[10].

- Area Rates are provided for though the *Community Area Rates Administrative Order* (2019-005-ADM)[11] and Private Roads through the *Private Road Maintenance Cost Recovery Administrative Order* (2018-003-ADM)[12].

- Tax Collection is facilitated through the *Revenue Collections Policy Administrative Order.* (Administrative Order Number 18)[13].

- Local Improvement Policies are found in the *"Street Improvement By-law" (*By-law S-400)[14].

- Development Charges are enabled in the *Capital Cost Charges By-law* (By-law C-600)[15] and the *Capital Cost Charges for Solid Waste Facilities By-law* (By-law C-800)[16].

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[5] The Area Rate Framework was presented by staff and reviewed/approved by both COW and Regional Council on October 22, 2013. http://legacycontent.halifax.ca/council/agendasc/documents/131022cow3.pdf

[6] https://www.halifax.ca/sites/default/files/documents/city-hall/legislation-by-laws/AO-10.pdf
[7] https://www.halifax.ca/sites/default/files/documents/city-hall/legislation-by-laws/By-LawT-700.pdf
[8] https://www.halifax.ca/sites/default/files/documents/city-hall/legislation-by-laws/2014-001-ADM.pdf
[9] https://www.halifax.ca/sites/default/files/documents/city-hall/regional-council/171031cow3.pdf
[10] https://www.halifax.ca/sites/default/files/documents/home-property/property-taxes/CommercialTaxOptions2015.pdf
[11] https://www.halifax.ca/sites/default/files/documents/city-hall/legislation-by-laws/2019-005-ADM.pdf
[12] https://www.halifax.ca/sites/default/files/documents/city-hall/legislation-by-laws/2018-003-ADM.pdf
[13] https://www.halifax.ca/sites/default/files/documents/city-hall/legislation-by-laws/AO-18.pdf
[14] https://www.halifax.ca/sites/default/files/documents/city-hall/legislation-by-laws/By-LawS-400.pdf
[15] https://www.halifax.ca/sites/default/files/documents/city-hall/legislation-by-laws/By-lawC-800.pdf
[16] https://www.halifax.ca/sites/default/files/documents/city-hall/legislation-by-laws/By-lawC-800.pdf

Practices:

- Budgeting for the Average Tax Bill – Under the *Halifax Regional Municipality Charter*, HRM is required to establish property tax rates for each fiscal year. The taxes paid by property owners depend not only on that tax rate but also on the owner's property assessment. In order to be more transparent, the municipality budgets on the basis of the change in the average tax bill, not simply the change in the tax rate.

- Monitor the Commercial Tax Share – HRM monitors the average residential and commercial tax bills. This allows it to compare the changing tax burdens in the residential and commercial areas. For example, commercial taxes have fallen to 38 per cent of total property tax revenues, down from 50 per cent in 1995.

Actions:

- A Tax and Fee Revenue Strategy will establish the guiding principles on user fees and the property tax system. That strategy will consider factors such as competitiveness of the Halifax region as a business destination, accountability, transparency, services, administrative costs as well as impacts on low-income residents. A greater emphasis on user-fees better ties cost with those that use services. Simply, pricing services will increase accountability and reduce relative reliance on property tax.

- The municipality's tax exemption and deferral programs (low income and non-profit) will be reviewed to ensure that they properly respond to the municipality's growing economy and are inclusive of its diverse population. This work is already underway.

- Cash flow and liquidity will be examined and compared against best practices. HRM should examine improved methods for cash flow analysis and monitoring. It should also examine different approaches for collecting the annual property tax bills, currently billed twice per year.

- The Residential/Commercial Tax Split will be evaluated to ensure it is transparent and serves the community properly. Building on work already completed, HRM will continue examining the impact of taxation on small business – with particular consideration given to assessment averaging and small property tax relief for parts of the commercial sector.

- To ensure transparency with taxpayers, HRM will share details regarding the cost to fund municipal services as part of the total tax bill. Future communications will include the cost of provincial mandatory contributions as well as the municipal services tax rate.

Policy Framework: Capital

Capital projects are prioritized according to the following principles:

- Connection to approved Regional Council priorities and plans

- Service impacts

- Risk profile

- Capacity to deliver

Policies that support these principles:

- HRM's *Regional Plan* outlines future settlement patterns, hence having a major influence upon future infrastructure requirements, such as linear assets, recreation facilities, parks land, libraries and fire services.

- Capital decisions are expected to reflect the Council Priority Areas. In 2020/21 these are: Economic Development; Service Delivery; Healthy, Livable Communities; Social Development; Governance & Engagement; and, Transportation. In 2021/22 there are four proposed Council Priority Areas: Prosperous Economy, Integrated Mobility, Environment and Communities.

- There are many strategic studies and plans which influence the development of infrastructure. Examples include the Integrated Mobility Plan (IMP), HalifACT, the Rapid Transit Strategy, the Green Network Plan, the Moving Forward Together Plan and the Urban Forest Master Plan. A number of these plans do not have a dedicated funding and cannot be accommodated within the current fiscal framework.

- Regional Council has established a target whereby 70 to 80 per cent of available funds are used for "Renewal" projects with the balance used for "Growth".

Practices:

- HRM uses a Capital Prioritization Framework for evidence-based decision making. It also uses a capital project business case template. The Framework aligns with Council priorities and provides a lens to consider recommendations – using decision matrixes based on the principles outlined above.

- HRM budgets for capital projects on a cash flow basis. It reviews probable funding capacity with all existing and proposed projects to determine the amount of work to be undertaken in each fiscal year. HRM budgets for operating costs of new assets (Operating Cost of Capital or OCC) by working with project management teams to analyze the likely operating costs of each project.

Actions:

- Staff are proposing the use of "<u>Strategic Initiative Funds</u>". These are dedicated funding plans such as reserves or debt financing (such as "Green Debt") for projects that are transformational in nature, are tied to an approved Regional Council strategy, and are likely to result in a discernable increase in the tax rate.

- HRM will actively explore opportunities for other financing sources for major infrastructure projects in support of strategic initiatives – such as funding through the FCM Green Fund and the Canadian Infrastructure Bank as well as other federal/provincial funding programs.

- <u>Asset Management Plans</u> will be developed for each major asset class. Establishing proper lifecycle costing can serve as a basis for future asset maintenance and recapitalization plans.

- HRM will continue to <u>improve its capital processes</u> and procedures. This will include improving:

    - Life Cycle Costing (LCC)
    - Capital projections and progress reports for capital projects
    - Processes for closure of competed and outdated projects
    - Prioritization and business case processes
    - Advance tendering and budgeting
    - Purchase vs Lease Analysis
    - Categorizing service levels
    - Funding plans

Policy Framework: Reserves

Reserve Policy is focused on the following principles:

- Plan for the long-term financial health and stability of the municipality; eliminating or mitigating unstable and unpredictable revenues.
- Ensure HRM has the ability to fund projects and events that produce long-term benefits, are strategic, or require significant cost sharing between budget approvals – and where there is sudden or unexpected business opportunity, where future obligations can be reasonably foreseen and where substantial risk to HRM may occur.
- Minimize significant budget fluctuations and reliance on debt financing.

Policies that support these principles:

- Financial Reserves Administrative Order (2014-015-ADM)[17] outlines the Reserve Policy.

Practices:

- Each reserve is supported by a business case outlining the reserve's objectives, the source of funds, and use of funds.
- Reserve balances are reported to Regional Council as part of quarterly reports.

Actions:

- Several reserve business cases will be revised. There is the opportunity to combine or redefine reserves where they can be tied more closely to the municipality's objectives and to provide maximum balances. This should provide greater clarity for Regional Council as to the current state of the reserves and the uncommitted balances.
- Review of the Strategic Projects reserve to expand into the focus on the achievement of Council's strategic priorities.
- Long-term Reserve Planning including specific annual and long-term targets for reserves. These targets should mirror long-term capital needs, reflect risk factors, and be flexible to allow HRM to take advantage of cost-sharing programs or non-governmental proposals.

Policy Framework: Debt

Since early on, the objective of HRM's approach was to increase the capital budget by using current year revenues, while reducing tax-supported debt outstanding. The principles it follows are:

- Ongoing renewal projects should be funded through current year revenues.
- Growth projects should be funded by debt.
- Projects can be funded by debt irrespective of any debt targets if any projected cost savings or new revenues are sufficient to offset the additional debt carrying costs.

[17] https://www.halifax.ca/sites/default/files/documents/city-hall/legislation-by-laws/AO-2014-015-ADM.pdf

Policies that support these principles:

HRM's Debt Policy sets debt and capital from operating targets for the Capital Budget. These targets are set as an amount per dwelling unit, to allow for economic growth in the municipality. Under the Debt Policy, the parameters are:

- Tax Supported Debt should decline by minimum 3 per cent per year
- Capital from Operating should increase by minimum 3 per cent per year after inflation

Practices:

- Debt and capital from operating targets are incorporated into planning for both the capital and operating budgets each year.
- HRM reports on the Tax Supported Debt to Regional Council each year, to confirm Council is comfortable with current and projected debt levels.

Actions:

HRM needs to review debt targets to ensure:

- The organization is on track to fund all ongoing renewal projects through non-debt instruments.
- Establishment of debt targets for the sole purpose of advancing major Council strategic initiatives such as objectives under HalifACT, the electrification of Halifax Transit buses, and IMP.

  Evaluation of the appropriate debt measurement for the municipality: debt service ratio, debt per capita, rather than an absolute dollar measurement of debt.
- The level of debt is appropriate for the current growth and economic trajectory and, as the capacity gap on capital expenditures declines, HRM will have the debt flexibility to support its planned infrastructure growth and the taxes to repay any debt outstanding.

Conclusions: Recommendations for Sustainability

HRM's current financial strategies and tools have served it well as it has grown over the past 25 years. At the time it was formed, the Halifax Regional Municipality quickly became a high-debt municipality that struggled with the ensuing population growth and its expanding service areas. The creation of Master Plans, the Regional Plan, and its Multi-Year Financial Strategy served it well over most of this time. The municipality has seen consistent decline in its debt levels as well as higher capital budgets and improved services through steady, measured growth. A range of financial tools allowed a level of fiscal sustainability that served it well over most of this time period. In the past several years, however, several key factors have shifted for the municipality.

- The Halifax region has entered a new phase of economic growth. The growth in population and economy has become much more rapid. Prior to the pandemic, Halifax was one of the fastest growing jurisdictions in the country. This growth brings significant opportunities as the municipality expands and attracts many newcomers, including immigrants. There is every reason to believe the end of the pandemic will see this trend continue, and possibly even strengthen, and that new opportunities will arise. However, this rapid growth also brings challenges. . Along with growth comes higher costs for governments and individuals as well as issues of affordability and inclusion, to ensure that all benefit from the growth that the Halifax region is experiencing.

- At the same time, in part because of that economic growth, there has been a sharp increase in public expectations for more services and amenities, such as recreation facilities, active transportation infrastructure as well as public safety demands. All of these come at a cost that must be carried by the tax payer, through the tax rate.

- Council itself has adopted several very important, ambitious strategies in response to public expectation, as a result of the prominence of Halifax as a regional hub and one of Canada's Big Cities. New major initiatives such as the Integrated Mobility Plan (IMP), HalifACT and the Rapid Transit Strategy are typical of the changes underway. These initiatives require leadership to proceed but their success is heavily dependent upon long-term planning, robust funding models and significant new sources of revenues. More and more, HRM finds itself approving long-term strategic projects without a clear sense of the overall long-term financial picture, how such initiatives will be funded, or what the various alternatives and opportunity costs are. Projects such as these put increasing pressure on existing services and are at risk of failure.

With these changes in the environment, HRM is at risk of falling behind in fiscal sustainability. It is critical to remember that fiscal sustainability does not imply either a high or low level of funding. Rather it requires future funding and expenses to be understood, planned out and consciously decided upon. HRM must be prepared to scale operations to meet varying levels of long-term sustainability. Therefore, this report recommends three key changes to its current policies:

- First, there is a strong need for robust, long-term planning. HRM needs to do a much stronger job incorporating long-term analysis into day-to-day decision making. This will allow the understanding, planning, and execution of strategic projects and long-term financial planning. It is therefore recommended that:

  - **Starting with the 2021/22 budget, and replacing the two-year detailed budget, staff will develop a long-term Financial Plan, focused on sustainability, that includes a one-year budget, a three-year outlook and a long-term plan based on the Strategic Vision that supports the operating, capital and reserve budgets and allows the municipality to meet long-term goals.**

- Secondly, HRM needs more flexibility on funding targets including debt and taxes. It needs to understand long-term revenue options for fees versus taxes and the level of each that the economy can support. This includes impacts on competitiveness, accountability, transparency, services, administrative costs as well as impacts on low-income residents.

  - **For the 2022/23 budget, staff will provide a Tax and Fee Revenue Strategy to Regional Council that will establish guiding principles for user fees and property taxes.**

  - **To support future revenue growth, staff will review tax policy and provide guidance on tax burden (affordability), a competitive regional tax environment, the residential-commercial tax share, options for taxation on small business and tax-related municipal service issues.**

- Lastly, HRM, needs to develop a funding approach for its strategic projects. Existing budget systems are not set up to provide the type of extensive funding to allow large strategic projects such as IMP, HalifACT and Rapid Transit to be successfully completed on time. Therefore, it is recommended that Regional Council direct the CAO:

  - **For the 2021/22 budget, staff will develop "Strategic Initiative" reserves for projects that are tied to an approved Council strategy and are significant enough to lead to a discernable increase in the tax rate or special funding that is outside the normal budget**

process. This should include any required changes to debt and reserve policies and should be eligible to be funded through dedicated tax levies.

- **Actively lobby the provincial government for changes to legislation to allow HRM to take advantage of financing programs such as the FCM Green Fund and the Canada Infrastructure Bank program outside of the NS Municipal Finance Corporation.**

Fiscal Sustainability Strategy Action Plan

The current financial strategies and tools of the Halifax Regional Municipality (HRM) have served it well as the Halifax region has grown over the past 25 years. However, in the past several years, many key factors have shifted. These include rapid economic growth, along with associated opportunities and challenges, a sharp increase in public expectations and Regional Council's desire to advance key strategic initiatives that protect the environment and provide services to residents, such as the Rapid Transit Strategy, the Integrated Mobility Plan (IMP) and HalifACT.

With these changes in the environment, HRM is at risk of falling behind in fiscal sustainability. It is critical to remember that fiscal sustainability does not imply either a high or low level of funding. Rather it requires future funding and expenses to be understood, planned out and consciously decided upon. HRM must be prepared to scale its operations to meet varying levels of long-term sustainability. Therefore, this report recommends three key changes to current policies:

- **Starting with the 2021/22 budget, and replacing the two-year detailed budget, staff will develop a long-term Financial Plan, focused on sustainability, that includes a one-year budget, a three-year outlook and a long-term plan based on the Strategic Vision that supports the operating, capital and reserve budgets and allows the municipality to meet its long-term goals.**

- **For the 2022/23 budget, staff will provide a Tax and Fee Revenue Strategy to Regional Council that will establish guiding principles for user fees and property taxes.**

- **For the 2021/22 budget, staff will develop "Strategic Initiative" reserves for projects that are tied to an approved Council strategy and are significant enough to lead to a discernable increase in the tax rate or special funding that is outside the normal budget process. This should include any required changes to debt and reserve policies and should be eligible to be funded through dedicated tax levies.**

Implementation of new strategies and processes

In addition to its three main recommendations, staff are working towards several new strategies and processes, many linked to their main recommendations.

- To enhance decision-making, improve financial transparency and gain a more client-centered perspective, the municipality will budget, and report based on its services. Following the implementation of the upgraded SAP system in 2022/23, HRM will move towards Service-Based Budgeting for 2023/24, including:
  - Improved costing and linking budgets and costs to services, service levels and strategies
  - Stronger reporting that is integrated into operating, capital and reserve budgets and projections as well as Key Performance Indicators (KPIs)
  - Use the new SAP to provide high quality cost and service information

- Commencing in 2022/23, Long-term Capital Planning will identify the on-going maintenance and replacement costs for assets currently used to deliver municipal programs (e.g. roads, buses, libraries and sports fields, as well as capital required for new and evolving services for a growing region). This will link to long-term operating and reserve budgets as well as debt needs. Asset management plans will be developed for each major asset class to:

    - Better utilize the full economic life of HRM assets and optimize operating costs Establish lifecycle costs and serve as a basis for short and long-term asset maintenance budgets and capital plans

- Commencing in 2021/22, Long-term Reserve Planning will include specific annual and long-term targets and reserves. These targets shall align with long-term financial plans, reflect risk factors and support municipal goals and future opportunities.
    - HRM's reserve policy and individual business cases (including minimum and maximum balances) will be reviewed and revised
    - Business cases will make the specific uses of reserves clearer, as well as how they support municipal sustainability objectives
    - Reserve reporting will make clearer the availability of reserve balances (in addition to their current and projected balances)

- Commencing in 2021/22, Long-term Debt Planning will make debt funding available for growing infrastructure needs; HRM will review its debt targets and set a level appropriate for the municipality's current growth and economic trajectory.
    - Debt levels should be measured relative to dwelling units, as a debt service ratio or a percentage of HRM revenues
    - As capacity allows, debt targets will be expanded to support strategic initiatives approved by Regional Council

- Commencing in 2022/23, HRM will update the work it has done on settlement patterns, so it can better understand current and future costs and revenues, as they relate to built form and specific areas of growth within the municipality.
    - If combined with service level projections, this should lead to a 20-Year Financial Model with a clearer understanding of growth cost recovery options, such as regional or greenfield development charges

Improvements to existing processes

In reviewing the changes and future actions in policies and practices that can be undertaken, staff recognized that many of these actions are the regular work of staff, are underway and/or are the focus of ongoing improvements. Such actions have been categorized as improvements to existing processes. In addition, continuing or commencing in 2021/22, analysis will be conducted, and financial processes improved in the following three areas:

Facilitate better-informed and focused decision-making

Recommendations to Regional Council should be communicated clearly and focus on high-level reviews and strategic decisions. Commencing with the 2021/22 budget cycle, it is proposed that:

- A four-year horizon be the basis for financial planning, analysis and projections including the Financial Implications section of Council reports; to align with this planning period, the Capital Budget be extended from three to four years.
- The detailed Year 2 biennial Operating Budget be curtailed. The second budget year did not meaningfully add to the public's understanding of long-term commitments or trends and did not remove the need for Council budget approval in Year 2.
- Large strategic projects and broad policy proposals include a stronger financial review and description of long-term financial implications; recommendations to commence such projects/proposals require comprehensive funding plans.

In addition,

- Annual budget processes will be improved to minimize the number of in-year recommendations that are made to Regional Council. Budgets and financial systems work best when Regional Council can see and prioritize all proposals at the same time.
- Clearly identify HRM service levels, so whenever a service improvement decision is approved, a funding plan can (and will) be confirmed.
- Conversely, HRM needs to develop a much greater sense of materiality; tax impacts of less than 1/20th of a cent ($250K) should be given less weight in financial planning, analysis and budget decisions.

Manage revenues and cash flow

- HRM will review best practices and explore improved methods for cash flow analysis and monitoring, including whether different approaches for collecting property taxes, currently billed twice per year, may be preferable. Implementation of the Tax and Revenue Module, as part of the SAP Business Transformation Program, will give HRM more flexibility in how it manages its tax bills.
- HRM will develop an approach to manage unpredictable revenues (such as Deed Transfer Taxes) which can fluctuate substantially, year to year, creating financial uncertainty. This could be accomplished with flexible budgets, by making conditional funding decisions or using long-term reserve contributions.

Maintain a strong assessment base and a competitive, equitable property tax system

- Mandatory provincial contributions are significant and are eroding the municipality's ability to fund municipal operations. HRM needs to work closely with the Nova Scotia Federation of Municipalities (NSFM) and the Association of Municipal Administrators of Nova Scotia (AMANS) to ensure that municipal and provincial program and funding responsibilities are accountable, transparent and aligned with government mandates.
- The property tax system shall be competitive for Halifax businesses and affordable for residents
    - HRM will analyze, refine and implement commercial assessment averaging as per Council's direction. It will continue to review small property tax relief.
    - The municipality's tax exemption and deferral programs – for low-income households and non-profit organizations – are being reviewed to ensure that they are responsive to the municipality's growing economy and inclusive of its diverse population.
    - The residential/commercial tax share will be evaluated to ensure it is transparent, competitive and serves the community properly.
    - Boundaries and structure for urban, suburban, rural and transit taxes will be examined.
- As discussed in the recommendations**,** Long-term Financial Planning will focus on sustainability, with features of flexibility and resilience. In addition, staff will provide greater focus on the following aspects of long-term planning:
    - Annual budget targets will be developed to include cost escalations and demographic impacts, as they relate to each service
    - The outlook and long-term plan will incorporate anticipated growth – both demographic and service level changes – so the capacity and cost to deliver future programs can be estimated and properly planned
    - Fiscal capacity should be maintained to allow HRM the flexibility to manage future program demands or participate in new opportunities/partnerships
    - Sensitivity analysis will help test for resilience and allow planning for cyclical changes, such as recessions, as well as unforeseen events, such as a pandemic