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June 30, 2014 Projected Year-End Financial Results and Budget Update - Operating

Recommendation:

1. That the 2014 Operating Budget be amended to decrease Transportation Services – 41 Avenue/Queen Elizabeth Highway 2 Interchange expenses and revenues by $15,540,000, as shown in Page 7 of Attachment 1 of the September 10, 2014, Financial Services and Utilities report CR_916.

2. That the Transportation Services – Roads Design and Construction capital profile 10-66-1484 - 41 Avenue/Queen Elizabeth Highway 2 Interchange be amended to remove all capital expenses and funding sources, as shown in Attachment 9 of the September 10, 2014, Financial Services and Utilities report CR_916.

Report Summary

This report provides the June 2014 year-to-date operating financial results and 2014 year-end projected results. Updates relating to economic conditions, debt and debt servicing, and Community Revitalization Levy programs are also provided. Recommendations are made to adjust the budget relating to the 41st Avenue/Queen Elizabeth 2 interchange project.

Report

This report presents the second quarter year-to-date operating results and projected year-end results compared to the approved budget for tax-supported, enterprise/utility and Community Revitalization Levy programs. The projections are based on the June 2014 year-to-date results combined with other available information. Projections are subject to change in future periods as additional information emerges.

The report also provides information related to the City's debt position and an economic update. A new section, expanding on Community Revitalization Levy financial reporting, has also been provided as Attachment 6 to this report. The expanded Community Revitalization Levy financial reporting will be included as a part of regular quarterly financial performance reporting.

Recommendations are made in this report to adjust the budget to align with the accounting for the 41st Avenue/Queen Elizabeth 2 interchange project.

A separate report providing a capital financial update as of June 2014 is also being presented to City Council on September 10, 2014.

<u>Tax-Supported Operations</u>

As of June 30, 2014, tax-supported operations are projecting a net unfavourable year-

end variance of $(10.9) million or a half of a percent of the overall expenditure budget. The unfavourable variance is a result of the following:

• Unfavourable snow removal costs in the Snow and Ice Control program (Transportation Services) due to greater than expected snow removal activities required in the first quarter of the year arising from increased snowfall late in 2013 **$(10) million.**

• Unfavourable Fire Rescue Services personnel costs due to fewer than anticipated retirements and less personnel discount savings from vacancies (Community Services) **$(2.6) million**.

• Police Services projected net year-end deficit arising from decreased Traffic Safety Act fine revenue and increased purchases of materials and equipment, partially offset by decreases in contractor costs and other net favourable revenue changes **$(2.5) million.**

• Net increase in fuel costs across tax-supported departments due to higher than budgeted prices (net of fuel hedging strategy to mitigate price increases) **$(2.4) million.**

• Increased spring cleanup costs within the Transportation Operations program (Transportation Services) due to unfavourable winter weather conditions **$(2) million.**

• Lower than budgeted supplementary tax revenues within the Taxation Expenses program (Corporate Programs) due to less than expected building completions **$(1.4) million.**

• Decrease in uncollectible property taxes in the Taxation Expenses program (Corporate Programs) **$3.1 million.**

• Increase in gas franchise fee ($2 million) and tax penalty ($1 million) revenues in the Corporate Revenues program (Corporate Programs) **$3 million.**

• Net reduction in North LRT operating costs within the Edmonton Transit program (Transportation Services) due to contractor delays in completing the signal system and safety testing (the opening date has been revised from June 2014 to December 2014) **$2 million.**

• Unbudgeted Enoch Fire Protection contract revenues in the Fire Rescue Services program (Community Services)
- **$1.1 million.**

• Other net cumulative favourable variances across tax-supported programs **$800,000.**

Police Services financial projections reflect the information received for the period ending May 31, 2014.

A table of year-to-date results and year-end projected results for tax-supported operations and the Quarters Community Revitalization Levy program is included as Attachment 1. Attachment 2 provides additional details on projected year-end variances where revenues, expenses, transfers to/from reserves or program variances in total exceed $500,000.

Recommendations - 41st Avenue/Queen Elizabeth Highway 2 Interchange Project

This project is managed by the City with the total project costs being funded through contributions from all three levels of government. The interchange is a provincial asset. Total costs related to the construction of the interchange are administered by the City with provincial and federal portions then recovered from the other orders of government as set out in a cost share agreement. The total budgeted project cost is $205 million, with the City's contribution being $72.5 million over the term of the project (2011-2015). The contribution remaining from the City in 2014 and 2015 is $57 million, which will be funded by provincial fuel tax ($40.4 million) and arterial roadway assessments ($16.6 million). The City's contribution is considered an operating expense, as the asset is ultimately owned by the province.

City Council approved this project through the Transportation Services – Roads Design and Construction capital profile 10-66-1484 (41 Avenue/Queen Elizabeth Highway 2 Interchange) for the total cost of construction, including the City of Edmonton, provincial and federal portions.

Recommendation 1

As the contribution from the City is operating in nature, Recommendation 1 in this report proposes to reflect the remaining City contribution towards this project within the Transportation Services 2014 operating budget. During the Spring Supplemental Capital Budget Adjustment process, a portion of the capital budget, including contributions from all levels of government, was transferred to operating. This report recommends decreasing the revenue and expense operating budget for the 41st Avenue/Queen Elizabeth Highway 2 Interchange project, within Transportation Services, by $15,540,000. This will adjust the revenue and expense budgets from $72,500,000 to $56,960,000, which reflects the remaining City contribution in 2014 and 2015 for this project. Refer to Attachment 1, Page 7.

Recommendation 2

Recommendation 2 in this report proposes to eliminate the remaining budgeted capital expenses and funding in capital profile 10-66-1484 (41 Avenue/Queen Elizabeth Highway 2 Interchange). These budgets are related to portions of the project funded by the other orders of government. Refer to Attachment 9.

These recommended budget adjustments have no net impact on the overall tax-levy budget.

Traffic Safety and Automated Enforcement Program

The Traffic Safety and Automated Enforcement program, within Transportation Services, is not currently projecting any excess photo enforcement revenues over the approved annual budget. Although there is an expectation for revenues to exceed budget at the end of the year, there is uncertainty as to the extent of the variance. The uncertainty is due to various factors, including weather, enforcement levels, driver behaviour, and photo enforcement technologies. In addition, limited historical trend information is available as the program has been fully managing photo enforcement operations since March 2012. Administration is also bringing forward a report to Council in the fall discussing a strategy for the Traffic Safety and Automated Enforcement program.

Based on these factors, the impact of photo enforcement revenues on tax-levy operations is uncertain at this time.

Year-to-date results for the program reflect $9.1 million in favourable photo enforcement revenues. The variance is primarily attributed to evidence based mobile enforcement deployment strategies and the optimization of the ticket review process.

Investment Earnings

The Capital Project Financing program year-end projections, within Corporate Programs, reflect additional investment earnings of $10 million. This is as a result of higher than expected investment returns and gains on dispositions.

Administration initiated a strategy within the 2009-2011 capital budget cycle to fund a portion of grant eligible projects with pay-as-you-go funding in order to receive matching grant contributions from other orders of government. This effort to maximize grant funding lead to an over-commitment of pay-as-you-go funding. The deficiency is being addressed in future capital budgets and by applying greater than budgeted investment earnings towards the shortfall. This report assumes the additional investment earnings of $10 million will be applied to the pay-as-you-go funding shortfall within the 2012-2014 capital budget.

After the application of the additional investment earnings, the shortfall is estimated to be $(20.3) million within the three-year 2012-2014 capital budget. The shortfall is being addressed through the proposed 2015-2018 capital budget being presented to Council later this year.

Reserves

Financial Stabilization Reserve

The Financial Stabilization Reserve was established in 1997 to provide flexibility in addressing financial risks associated with revenue instability and unforeseen costs on a transitional basis, and to ensure the orderly provision of services to citizens. The unappropriated balance in the Financial Stabilization Reserve is $101.6 million. This is above the minimum level of $88 million and below the target level of $146 million as set in City policy C217B *Reserve and Equity Accounts* and based on the 2013 audited financial statements.

Current Planning Reserve

The Current Planning Branch implemented a new cost-recovery business model in 2010, approved by City Council, with one objective being to ensure that reserves are in place to maintain and enhance customer service regardless of transient economic conditions. This year it is projected that higher than forecast development activity will result in greater than budgeted funds being transferred to the Current Planning Reserve. Rather than a budgeted transfer to the reserve fund of $1.5 million, a net transfer of $2.5 million to the reserve is projected for 2014, creating a projected year-end reserve balance of $25.1 million. This is above the minimum level of $18.6 million and below the target of $46.5 million (75% of annual budgeted expenditures) calculated in accordance with City policy C570 *Current Planning Reserve*. Refer to Attachment 3 for an explanation of the Current Planning business model and a further financial update.

<u>Potential Impacts to be Monitored</u>

Tax-supported year-end projected results reflect the best information available to date. Certain items involve a greater degree of uncertainty. Administration will continue to monitor these matters and update projections if necessary.

- All in-scope employee contracts, with exception of the Edmonton Fire Fighters union, expired by the end of 2013 and are in negotiations.

- Snow and ice control expenditures are weather dependent and difficult to predict. Any fluctuations from current assumptions may further impact the Transportation Services Snow and Ice Control program projected expenditures. The current projection is for a $(10) million unfavourable expenditure variance. Year-to-date results reflect a $(11) million unfavourable expenditure variance.

- Historically, fluctuating fuel costs may cause a negative impact to tax-supported operations, the most significant user being the Edmonton Transit program within Transportation Services. A hedging strategy covering approximately half of the expected fuel volume in 2014 mitigates a portion of the risk. Year-end projections for all users reflect $(2.4) million in unfavourable variances due to net increases in fuel costs.

• The revised Traffic Safety and Automated Enforcement program strategy (being presented to Council in fall 2014) and various other external factors may cause an overall net variance from the year-end approved budget for this program. Refer to detailed discussion in the Traffic Safety and Automated Enforcement program section earlier in the report.

• Foreign currency exchange rate fluctuations may cause an overall net cost increase for vehicle maintenance parts.

Community Revitalization Reserves

Community Revitalization Levy reporting of year-to-date budget and actuals as well as budgets and projections to year-end is provided in Attachment 1 (Quarters Community Revitalization Levy) and Attachment 4 (Belvedere Community Revitalization Levy). Further reporting on Community Revitalization Levy cash flows over the term of the Community Revitalization Levy and other related information are shown in Attachment 6.

Enterprise and Utility Operations

A table of year-to-date results and the projected year-end position for enterprise and utility operations and the Belvedere Community Revitalization Levy program is displayed in Attachment 4. Attachment 5 provides details on projected year-end variances where revenues, recoveries, expenses, transfers to/from reserves or program variances in total exceed $500,000.

Debt

The *Municipal Government Act* and related regulations establish limits for municipal debt levels and annual debt servicing costs.

Debt Limits

Total Debt – June 2014 - Based on borrowing and repayments to June 30, 2014, the City has $2,732.8 million in total debt (net), 59.2% of the *Municipal Government Act* debt limit.

Total Debt – December 2014 (projected) - Borrowing and repayments for the remainder of the year would result in the City having projected total debt (net) of $2,904.8 million, 62.9% of the *Municipal Government Act* debt limit.

Debt Servicing Limits

Debt servicing includes annual principal and interest on total outstanding debt.

With total debt servicing of $309.8 million as at June 30, 2014, 38.3% of the maximum debt service limit as set out in the *Municipal Government Act* has been used.

The internal *Debt Management Fiscal Policy* (C203C) sets more conservative debt service limits than those established in the *Municipal Government Act*, with limits for all City operations and tax-supported operations. As at June 30, 2014, debt servicing is 57% of the debt service limit for all borrowing and 75.6% of the limit for tax-supported operations, as defined under the City's policy.

Debt levels and debt limit information are displayed in Attachment 7.

The significant increase in debt servicing in 2014 and 2016 is due to the full repayment of short-term borrowing. Short-term borrowing of $120 million has been taken as of June 30, 2014, to finance fast-tracking of capital expenditures for projects ultimately approved to be funded through Municipal Sustainability Initiative grants and provincial fuel tax. The short-term borrowing is being repaid as funding from these grant sources become available, thereby reducing the availability of these grant funds in the next capital budget cycle. Based upon anticipated expenditures and flow of grant funding, additional short-term borrowing is not projected at this time.

Committed debt beyond 2014 includes construction of the Downtown Arena and related development, Valley Line LRT, Walterdale Bridge, and the Northwest Police Campus.

Economic Update

An operating economic update for the second quarter of 2014 is provided in Attachment 8.

Policy

The Financial Services and Utilities report CR_916 meets the reporting requirements outlined in the *Municipal Government Act*.

Corporate Outcomes

This report supports the corporate goal of securing Edmonton's financial sustainability by helping ensure the City has well managed and sustainable assets and services, a resilient financial position and on-going balanced revenue streams.

Justification of Recommendation

1. The reduction of revenue and expenses in the 2014 Operating Budget will provide a more accurate reflection of the remaining City contribution to the project.
2. The expenses and funding can be removed as they relate to items funded by other levels of government.

Attachments

1. Tax-Supported Operations - June 30, 2014 Financial Results and Projections
2. Tax-Supported Operations - Year-End Variance Explanations - June 2014
3. Current Planning Financial Update - June 2014
4. Enterprise and Utility Operations - June 30, 2014 Financial Results and Projections
5. Enterprise and Utility Operations - Year-End Variance Explanations - June 2014
6. Community Revitalization Levy - Financial Update - June 2014
7. Debt Update - June 2014
8. Economic Update - June 2014
9. Capital Profile 10-66-1484 - 41 Avenue Queen Elizabeth Highway 2 Interchange