**St. Catharines**

# Corporate Report
## Budget Standing Committee

**Report from:** Financial Management Services, Director

**Report Date:** April 13, 2022

**Meeting Date:** May 25, 2022

**Report Number:** FMS-B005-2022

**File:** 10.57.12

**Subject:** 2023 Operating Budget Guidance

## Recommendation

That the Budget Standing Committee (BSC) provide staff with an overall expenditure budget guidance increase of 7% for the 2023 Operating Budget.

## Summary

This report includes an economic outlook and also outlines the financial opportunities and challenges that may impact the program and service offerings for the City in the upcoming year.

Similar to 2020 and 2021, the COVID-19 pandemic is continuing to place substantial impact on the City's operations and fiscal position in 2022, including significant inflation increases. The City will continue to stay focused on recovery in 2023 in order for the City to maintain a state of financial health as part of the long-term fiscal strategy.

The City will be looked to for guidance and support for our residents and businesses as they too recover from the global pandemic. The last two budget years have been anything but normal. Several adjustments were made in year and during the 2021 and 2022 Annual Operating Budget development which are not sustainable over the long-term.

Comparing 2023 to 2022 will not be a fair comparison as items were dialed back and reductions were intended to be one-time. Therefore, as guidance is provided for the 2023 operating budget, consideration needs to be given to the unusual circumstances that the City, the Region, the Province and the Country are in and the importance of recovery and the key role played by the City. As our community continues its path to economic recovery and sustainability, the City needs to make difficult choices that balance the needs and expectations of the community with the economic realities and responsibilities faced by the Corporation. The lower the expenditure guidance provided for 2023 will impact the time it takes the City to return to our new normal. Staff recommend BSC to provide an overall expenditure budget guidance increase of 7% for the 2023 Operating Budget.

# Background

At the Budget Standing Committee (BSC) meeting of May 31, 2017, the following motion was approved:

> "That staff return to the BSC at the beginning of each annual operating budget cycle with an update on the rolling 12-month average of CPI-common in order for the BSC to set the annual overall expenditure budget guidance."

At the March 27, 2019 BSC Strategic Plan meeting, discussions addressing annual overall expenditure budget guidance for 2020 occurred. It was stated that inflation rates alone should not dictate annual budgeted expenditure increases. Consideration needs to be given to new programs, program changes, staffing requirements and changes in strategic corporate direction.

At its meeting on January 24, 2022, the BSC members and staff discussed items including inflation policy that would guide City's budget development process, opportunity for City to establish inflation index, ongoing inflationary increases, supply shortages, weather events and related budget pressures. The BSC requested staff to have internal discussions, research related policies available in other municipalities and through AMCTO, FCM, AMO, and LUMCO.

In addition, at its meeting of March 21, 2022, the BSC requested staff to report outlining the impact on inflation of corporate costs to be included as part of the Budget Guidance Report.

# Report

## Economy Outlook

According to Scotiabank's Forecast Tables published on April 12, 2022[1], the City's current financial institution, Scotiabank has provided an outlook on Canada's economic performance. The following is the CPI (Consumer Price Index) quarterly forecast for the remainder of 2022 and 2023.

**Table 1 – Scotiabank Forecast – Canada Total CPI**

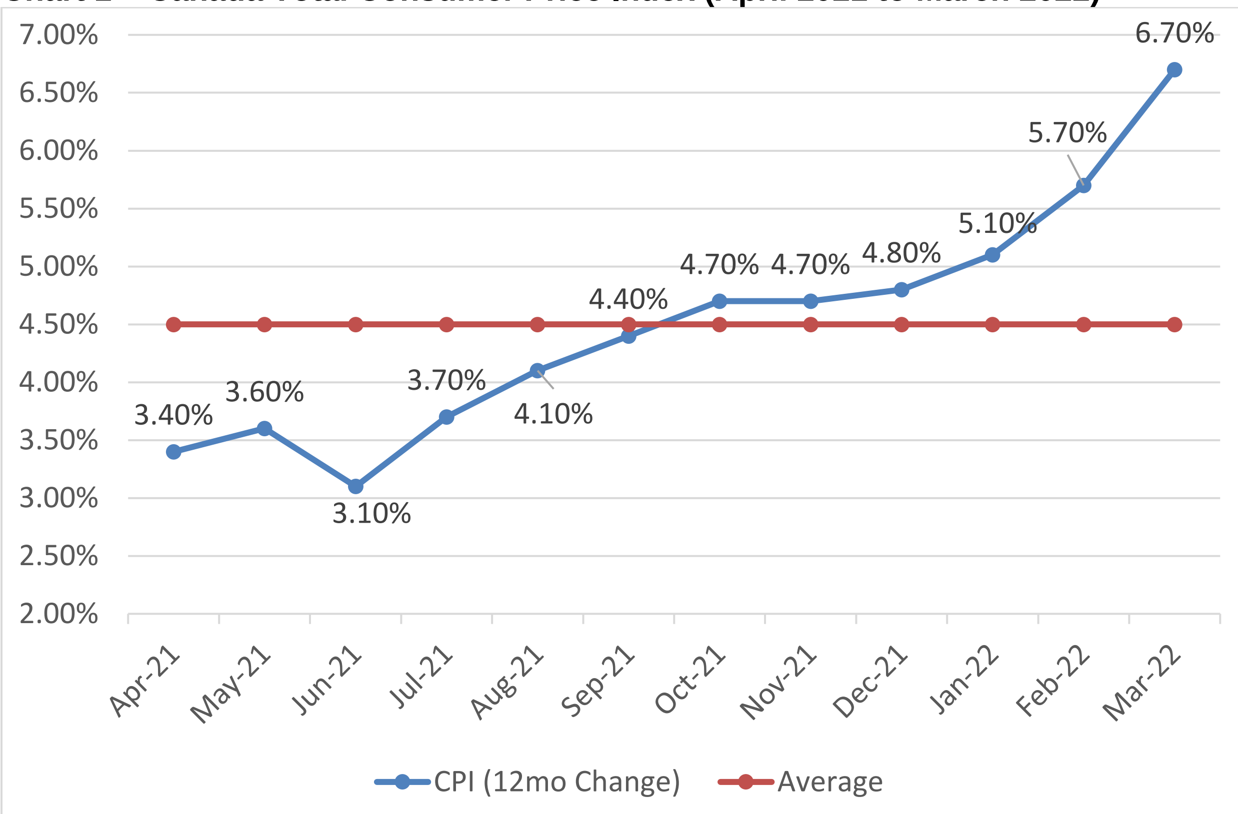
| | 2022 | | | 2023 | | | |
|---|---|---|---|---|---|---|---|
| | **Q2** | **Q3** | **Q4** | **Q1** | **Q2** | **Q3** | **Q4** |
| **Canada – Total CPI** | 3.0 | 3.4 | 3.4 | 3.3 | 3.4 | 2.9 | 2.6 |

[1] Aggressive Policy Tightening to Come: Scotiabank's Forecast Tables | Post
https://www.scotiabank.com/ca/en/about/economics/economics-publications/post.other-publications.global-outlook-and-forecast-tables.scotiabank%27s-forecast-tables.2022.april-12--2022.html

# Budget Pressures
## Inflation
One of the main pressures affecting the 2023 budget will be the impact of inflation on goods and services purchased.

Chart 1 below illustrates the trend of Canada Total Consumer Price Index in the past 12 months[2]. The 12-month average change in CPI from April 2021 to March 2022 is 4.50%.

**Chart 1 – Canada Total Consumer Price Index (April 2021 to March 2022)**




The Scotiabank Forecast Tables indicate that inflation in Canada will remain well outside the Bank of Canada's (BoC's) inflation control range owing to the combined impact of the strength of global demand on input prices to date, the lagged impact of supply delivery challenges, the consequences of the war in Ukraine, the strength of the Canadian job market, and persistent upward pressure on rents as house prices continue to reach new highs.

The inflationary pressures resulting from higher commodity prices will fade over time, as will some pressures that are associated with logistical bottlenecks. This should lead to

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[2] Consumer Price Index, 2000 to Present - Bank of Canada
https://www.bankofcanada.ca/rates/price-indexes/cpi/

inflation moderating in the second half of the year and into 2023, yet it is clear that inflation expectations of both households and firms are uncomfortably high. This, and the economy being in excess demand, will keep inflation above the BoC's target through 2023.

Scotiabank is anticipating the average annual inflation of 5.9% in 2022 and **3.2%** in 2023.

While the CPI is a commonly used benchmark in estimating inflationary impacts, it does not accurately reflect the mix of goods and services acquired by the City.

The global pandemic continues affecting the supply of materials and the backlog that is associated with it, which leads to demand exceeding supply and market price increases. The City as a corporation provides essential municipal services to its residents and visitors such as fire services, repairing broken infrastructure, responding to climate events like snow and flooding, has been and will continue to be negatively impacted by the fast-escalating inflation increases.

In preparation of this report, all City Departments were surveyed and asked to provide feedback on how recent inflation increases have impacted their financials and service delivery.

Appendix 1 of this report outlines the survey results received from various City departments on the inflationary increases experienced in the past one to two years on the goods and services purchased.

It is evident that pricing of various goods purchased by the City has far exceeded the reported CPI. In some areas, CPI target is not indicative of the financial pressures the City has seen in the past. In order to come in at budget guidance based on total CPI target staff have not been able to be proactive with a number of initiatives, delayed implementation of others, assumed risks and not been able to address the significant pressure related to infrastructure funding.

Considering the combination of significant inflation increases and COVID-19 financial impacts, City departments have taken all necessary steps to mitigate the risks by deferring or reducing non-essential purchases and services in order to maintain service levels for legislated and essential services. However, as the City moves out of the pandemic into recovery and improved fiscal health, annual budget increases at the rate of CPI will not achieve this objective.

**Municipal Price Index (MPI)**

A Municipal Price Index (MPI) is a measure of inflation based on indices applied to specific line items weighted to the extent those line items impact the municipality's budget. The weighting is based on five years' worth of actuals and the most recent year's budget; therefore, very reflective of the actual costs incurred by the municipality over time.

Staff researched on government organizations and other Canadian municipalities on information available on MPI.

The research shows that several municipalities have experimented with the MPI, and most have either reduced their support or discontinue its use. The exception is the Town of Milton. The Town has been using either the MPI or components of it for several years in several aspects of their financial planning.

Municipalities that used MPI at one point in the past and have stopped or are planning to stop include Waterloo, Cambridge, Oakville, and Thunder Bay. Municipalities that have explored the concept of MPI but decided against implementing include Barrie, Kitchener, and Greater Sudbury. Municipalities using the MPI as a high-level guidance tool include Calgary and Edmonton.

**Pros**

- A more flexible methodology than CPI, accounting for the evolving nature of programs and spending undertaken by the organization;
- More detailed form of planning, which can be used to address or highlight anomalies in budgeting and actual spend;
- Higher transparency in the composition of expenditures and assumptions utilized

**Cons**

- Administratively intensive to develop and requires annual updates;
- Requires multiple forecast sources, where one is unavailable it would be replaced by another inflation factor;
- Open to higher amounts of interpretation

Niagara Region adopted the Budget Planning By-law in 2020 which defines the increase in budget to provide base services, excluding revenues and the costs of growth and capital, should be prepared with reference to an appropriate inflationary factor as determined by Council at the planning meeting for the new budget year. The price index that may be used for an inflationary factor is the core consumer price index (CPIX) as made available through StatsCan.

## Employee Resources

### Union Collective Bargaining Agreement

The City’s major union groups are undertaking negotiations in renewing their Collective Bargaining Agreements. The results of the negations are unknown at the time of this report. Employee compensation increases will continue to be part of the pressures on the Annual Operating Budget.

### Retention and Recruitment

The success of the City is highly dependent on the workforce to deliver essential, consistent, and quality services to the community. As part of its compensation strategies, the City is also in the process of reviewing the compensation levels of the Exempt Group (Management Group) to ultimately enhance the City’s staffing recruitment and retention.

Social challenges in the City have created an environment of increased needs, response, resources, and service requests on City operations. Departments across the Corporation are left trying to find balance between community risk management while also ensuring our most vulnerable population is supported within the existing social support system network. Enhanced investment to staff resource, employee retention, training, mental wellness protection, safety equipment and heavy equipment is required to create a safe, compassionate and supported working environment for City employees.

### Living Wage Employer

As the City commits to become a Certified Living Wage Employer by end of the 2024, staff have developed a phased-in plan to increase the compensation rates for positions that are impacted towards the target. On November 1, 2021, the new Living Wage in Niagara is $18.90 per hour which represents $0.78 increase from previous Living Wage of $18.12 (updated in 2019).

### OMERS Plan Change

Effective January 1, 2023, OMERS will remove the current eligibility requirement for non-full-time (NFT) employees to join the Plan. This will allow all NFT employees who work for an OMERS employer, who are currently not OMERS members, to join the Plan at any time on or after January 1, 2023. More information is expected to become available in the next months. The City needs to increase the overall employer matching contribution to the Plan in light of this eligibility expansion.

## Insurance Renewal

Staff are looking at ways of mitigating the impact of the increase of insurance premiums. Staff have been advised by the City’s insurance broker that the insurance market has stabilized, and the City should expect premium increases of no more than 10% for 2022-2023 renewal.

## Funding Development Charge (DC) Grants and Transitional Rates

As part of the City’s approval of DC’s in 2021 number of grant exemptions and transitional rates, which require funding from other sources other than DCs. The City has limited funding sources; therefore, these items require funding through the annual tax levy.

Due the uncertainty around the time of building permit issuance and wide range of potential property values, it is difficult to forecast estimated DC foregone revenues for 2022 and beyond. For DC Grants, based on the known new developments, the estimated annual tax levy support will be $250,000. The City also needs to fund the uncollected DC’s from 2021 in the amount of $1.6 million which will require annual tax levy support of $400,000 for four years.

If these DC supports in the amount of $650,000 annually comes back into the 2023 operating budget, the increase on the expenditure budget will be **0.62%** from 2022 to 2023.

## COVID-19 Financial Recoveries

In order to mitigate COVID-19 financial impacts with the consideration of taxpayer affordability, through the 2022 Operating Budget process, the City implemented a number of major mitigation measures to stabilize tax levy increase.

### Budget Deferrals

The budget items that have been deferred in the 2022 budget will need to return in future years. In the 2022 budget, the total deferral of major projects and budget increases was in the amount of $1.19 million. Deferred projects and initiatives will need to be brought back in order to achieve Council strategic goals.

If these items deferred in 2022 budget need to come back into the 2023 operating budget, the increase on the expenditure budget will be **1.14%** from 2022 to 2023.

Deferred budget increases including contribution to Capital, funding for Development Charge forgone revenue and grants, annual provision to Building Improvement Reserve, tree maintenance contract, etc. will need to be added back to the 2023 Operating Budget in order to restore service levels and maintain long-term financial sustainability.

### Reserve Usage

The City has used reserves in both 2021 and 2022 to mitigate budget pressures. The total amount of reserves used in the 2022 budget was $4.07 million. However, these contingency reserve and reserve funds are by no means infinite. And therefore, this approach is not sustainable and will cause increasing pressure on the City's property tax rates in future years.

In the 2022 approved budget, total of $2.45 million was utilized from the Tax Rate Stabilization Reserve (TRSR) for one-time expenditures, COVID-19 impacts, and support required to achieve prior year surplus contribution. In the 2023 budget, the COVID-19 related revenue losses are expected to return to normal level and no longer require reserve funding support. COVID-19 related expenditure budget (cleaning, PPE, signage, and security services) will remain at appropriate levels after staff review the needs for 2023. Therefore, the estimated net impact from the reduced usage of the TRSR in the 2023 budget is $1.11 million.

In the 2022 approved budget, total of $684,270 was utilized from the Civic Project Fund (CPF) as one-time funding source. Through Report FMS-B018-2021 Council approved the following motions regarding the future usage of the CPF:

> "That annual usage of the Civic Project Fund for Operating Budget support be reduced by 20% of the 2021 level each year 2023 to 2026 targeting zero Operating Budget support from the Civic Project Fund starting in 2027: and
>
> That the annual usage limit on special projects be set at 10% of the prior year ending balance of the Civic Project Fund starting in 2023."

Therefore, the estimated reduction of usage of the CPF in the 2023 budget is $342,000.

According to the 2020 Community Improvement Plan (2020CIP) Report PBS-154-2020, the reserve usage from the CIP Reserve will decrease from $95,000 to $50,000 in 2023 for CIP staffing expense.

The reduction in reserve usage in the amount of $1.50 million will have an estimated impact on the 2023 expenditure budget of **1.43%**.

## Asset Management Plan (AMP)

On October 4, 2021, Council endorsed the 2021 Asset Management Plan (AMP) for Core Assets, which provides a strategic guide supporting asset related activities for core assets valued at more than $5 billion. The Approved 2022 Capital Budget includes amounts that are in line with the anticipated annual funding included in the AMP. For the development of 2023 Capital Budget, staff will continue to follow guidance provided by AMP and prioritize capital projects.

### Operating Impacts from Capital Budget

Strengthening Asset Management practice requires undertaking a full lifecycle approach to infrastructure acquisition. Projects within the 2022 Capital Budget, that are anticipated to increase subsequent future operating budgets (2023 and beyond), include a new splashpad, James Street Civic Square and the Pathway within the Hydro Corridor. Each of these projects which increase services provided, are anticipated to require additional on-going operational and maintenance support once the project is complete.

Staff review the projects included in the capital budget and forecast and identify the operating impacts to be reflected in the annual operating budget in future years.

## User Fees

The Staff teams work around the development of 2023 Rates and Fees began in early March 2022. Guidance provided to City departments at that time was an increase at 2.9%., which was based on the inflation information available at that time. This is lower than the most recent Scotiabank forecasted 2023 CPI of 3.2%. With the fluid situation of inflation departments were encouraged to consider increases for their rate and fees between 3.2% and 5.0%. If the City is setting user fees increase lower than CPI increase, it creates additional pressures on the City's Operating Budget.

Some user fees revenues are forecasted to be declining due to legislative or market changes. For example, revenues for Break Open Licence Fees (Estimated Revenue Loss $12,000) Changes to the industry is anticipated to reduce revenues. In addition, revenues for Civil Ceremonies (Estimated Revenue Loss $20,000) Revenues are expected to decrease as there is now greater competition in this field with five Niagara municipalities now providing comparable services at a similar price.

## Financial Implications

Based on the 2023 CPI forecast as well as some of the known significant pressures to the expenditure budget is **6.4%**. Therefore, through this report staff are recommending that BSC provides an overall expenditure budget guidance increase for the 2023 Operating Budget for **7%**, based on the 2023 CPI forecast as well as known expenditure budget pressures

## Conclusion

The City continues experiencing financial challenges due to the COVID-19 pandemic and fast-escalating inflation increase. Staff are recommending that BSC providing an overall expenditure budget guidance increase for the 2023 Operating Budget based on the information in this report.

In providing the budget guidance, consideration needs to be given to the unusual circumstances that the City, the Region, the Province and the country are in, and the importance of recovery and the key role played by the City. The lower the expenditure guidance provided for 2023 will impact the time it takes the City to return to our new normal.

## Notifications

Ken Su and Karen Smith Curtis, St. Catharines Public Library
Dan Pilon, Niagara District Airport
Colleen Smith and Carlos Robayo, FirstOntario Performing Arts Centre
Jeff Dixon, Meridian Centre

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## Appendices

1. Price Index of City Acquired Goods and Services (Sample)

**Appendix 1**

| | Expenditure Category | Price Index* |
|---|---|---|
| **Construction Costs** | | |
| 1 | Building | 40% |
| 2 | Watermains | 1% |
| 3 | Sanitary Sewers | 10% |
| 4 | Storm Sewers | 10% |
| **Fleet Costs** | | |
| 1 | Fuel - Gasoline | 20% |
| 2 | Fuel - Diesel | 36% |
| 3 | Fleet Replacement - Fire Trucks | 15% |
| 4 | Fleet Replacement - Dump Trucks | 16% |
| **Equipment** | | |
| 1 | HVAC System | 87% |
| **Materials** | | |
| 1 | Pavement Marking - Hand/Zone Paint | 300-500% |
| 2 | Pavement Marking - Longitudinal Lines | 50-200% |
| 3 | Sewer Pipe - 4" | 82% |
| 4 | Sign Posts | 62% |
| 5 | Service Box | 27% |
| 6 | Concrete - 32MPA | 26% |
| 7 | Plant materials (Bulbs & Flowers) | 25% |
| 8 | Oil - 5W/30 | 22% |
| 9 | Oil - 15W/40 | 21% |
| 10 | Copper Pipe - 1" | 16% |
| 11 | Copy Paper - 8 1/2" x 11" | 13% |
| 12 | Brown Paper Towels | 13% |
| 13 | Toilet Paper | 13% |
| 14 | Sod | 12% |
| 15 | Repair Clamp - 6" x 12" | 10% |
| 16 | Water Pipe - 8" | 9% |
| 17 | Granular - 3/4" TB | 8% |
| 18 | Asphalt - HL8 | 7% |
| 19 | Hymax Coupling - 8" | 6% |
| 20 | Asphalt - Cold Mix | 4% |
| | | |
| | | |

**Note:**
* Price Index calculated based on price increases in 2021 and 2022 for the goods and services acquired by the City.