DATE: April 16, 2018

REPORT TITLE: **2018 ANNUAL UPDATE ON REGION OF PEEL’S FINANCIAL CONDITION**

FROM: Stephen VanOfwegen, Commissioner of Finance and Chief Financial Officer

OBJECTIVE

To provide an annual update on the Region of Peel’s financial condition and management actions under its Long Term Financial Planning Strategy.

REPORT HIGHLIGHTS

- The Region of Peel’s (“Region”) Triple “A” (AAA) credit rating has been reaffirmed by credit rating agencies.
- Actions implemented from the 2017 Financial Condition Scorecard include: a 2018 Budget that was in line with inflation and implementation of infrastructure levies to support state of good repair requirements and mitigate potential sustainability risks in the long term.
- The Financial Condition Scorecard shows the Region is within acceptable ranges for nine of the twelve indicators. Recommended actions for three indicators are included in Appendix I.
- The 2018 Financial Condition Scorecard includes actions to mitigate longer term risks to ensure the Region continues to remain financially healthy.
- A refresh of the current Long Term Financial Planning Strategy will be completed by spring 2019 to respond to the changing environment and to mitigate long term risks.

DISCUSSION

1. Background

In April 2013, Regional Council approved the Long Term Financial Planning Strategy (the “Strategy”) to address the increasing financial pressure that Peel’s growing and evolving community is putting on its services and programs. The Strategy applies a disciplined, comprehensive and integrated approach that identifies and manages the risks to the Region’s long term financial sustainability and credit rating. To implement the Strategy, a Financial Management By-law is utilized to govern all financial policies including the Development Charges and User Fee By-laws, the Reserve Management, Budget, Asset Management, Investment, Debt, Cash Management and Energy Hedging policies.

To assess the Region’s financial health, an annual financial condition scorecard was developed that utilizes financial performance indicators in three key areas; financial sustainability, financial vulnerability and financial flexibility.
As an overview of overall financial condition, the Region’s AAA/Aaa credit rating was reaffirmed by both Standard & Poor’s Global Ratings and Moody’s Investors Service in 2017.

a) Status of the 2017 Financial Condition Scorecard Recommendations

The 2017 Financial Condition Scorecard was reported to Council in April 2017. It indicated that the Region was overall financially healthy and included the following actions to maintain its financial condition:

- Include a 1.0 per cent tax levy and 3.5 per cent utility rate infrastructure levy in the 2018 Budget to mitigate sustainability risks in the long term; and,
- Address the trend of declining non-residential tax revenue through a review of the changing nature of employment.

The above tax infrastructure levies were approved through the 2018 Budget, however the utility rate infrastructure levy was increased to 5.0 per cent due to subsequent assessments as presented to Council on October 12, 2017 in a report titled “Overview and Update on the Status of Reserves”. Assessing the impact of the changing nature of employment is ongoing.

b) Long Term Financial Planning Strategy supporting Council Outcomes

The Strategy is used to set priorities for the resources needed to achieve the objectives set by the Strategic Plan and supports the cost efficient delivery of Regional services. Long-term sustainability is achieved when the pillars of financial sustainability, financial vulnerability and financial flexibility are balanced.

Currently, the Strategy is being used to inform decision making and to support long term service outcomes and will continue to help provide Council with financial context as it considers new priorities, program strategies and policy changes as noted above.

2. 2018 Financial Condition Scorecard

Staff assessed the Region’s current financial condition using the financial performance indicators on the Financial Condition Scorecard (Appendix I). The scorecard shows that the Region is within acceptable ranges for nine of the twelve indicators and actions are recommended for three indicators. The summary of the financial performance indicators and the recommended actions to mitigate potential risk to the Region of Peel’s long-term financial sustainability and credit rating are as follows:

Sustainability:

a) Tax Rate in Line with Inflation

Since the implementation of the Strategy in 2013, the average net tax levy increase was 2.0 per cent between the years 2014 to 2018, which is in line with the Bank of Canada inflation target range of 1–3 per cent.
During the 2018 Budget, Council established a target for the 2019 Budget at a 2.1 per cent net tax levy increase plus 0.3 per cent for Council priorities such as Waste Diversion and Seniors Health & Wellness Centre. The net tax levy target of 2.4 per cent is within the target range for inflation set by the Bank of Canada.

b) Adequate Capital Reserves – Tax

Analysis of the capital reserve requirements based on the 2018 to 2027 Tax Supported Capital Plan indicates that current reserve levels and contributions are not sufficient to fund the 10-year Capital Plan. The projected shortfall of $0.4 billion includes the estimated costs for the regional tax programs’ capital plan and the social housing portfolio including those owned by all housing providers. A major focus is on housing provider viability by having adequate capital reserve balances to fund all necessary capital requirements. Peel’s housing stock is aging and there will be increased pressures on the Region to help maintain its stock.

For long term sustainability, staff included a one per cent infrastructure levy that was approved in the 2018 Budget and an increase will be proposed for 2019 to close the funding gap to support the 10 capital year plan.

c) Adequate Capital Reserves – Utility

Assessment of the state of good repair capital reserve requirements for the 2018 to 2037 Utility Supported Capital Plan indicates that current reserve levels and contributions are not sufficient to address the state of good repair of existing and new regional utility infrastructure over the twenty year period. Based on the reserve adequacy assessment, there is a projected funding shortfall of $1.9 billion by the end of year 2037. In order to maintain a state of good repair, the 2018 Utility Rate Budget included a 5 per cent rate levy increase to support Peel’s long term infrastructure requirements.

For long term sustainability, staff included an increase of 5 per cent for 2018 and will propose similar increases for years 2019 to 2022 to close the funding gap to sustain the capital plan. The Region’s utility rate is comparatively lower than other GTA municipalities and will continue to remain lower with the implementation of the forecasted increases. Staff will continue to seek to mitigate the shortfall through ongoing review of capital requirements and funding.

d) Focus GTA Survey – Value for Tax

The Focus GTA Survey for spring 2017 indicates that the majority of Peel residents (75 per cent) consider the programs and services offered by the Region to be good value for their tax dollars. The survey results are in line with those in prior years. The results of this study confirm that the Region’s priorities align to the issues raised by the communities in Peel.
Vulnerability:

e) Less than 20 per cent Development Charge increase required

In 2015 the Development Charges (DC) By-law was updated with increased rates to offset the known shortfall that had developed since the passing of the 2012 DC By-law. In May 2017, staff updated Council on the performance of DC revenues over the past ten years and the impact of recent efforts to reduce risks to the financial sustainability of the DC program. At that time, staff also updated Council on the results of the DC rates adequacy test based on the 2017 Capital plan, which indicated a 5.4 per cent increase in DC rates to ensure the financial sustainability of the growth in capital program. Since the estimated increase falls well within the 20 per cent threshold for an automatic update of the DC by-law, an increase to the existing DC rates is not required at this time.

Notwithstanding, staff are working with the development community and the local municipalities on a new approach to growth planning and financing. Efforts by Council through the new approach have reduced the DC related debt by $600 million as compared to the forecast in the 2012 DC Background Study as at December, 2017. Staff will report to Council on the performance of DC revenues and the adequacy of DC rates in May 2018.

f) Less than 50 per cent of the Budget is funded by property tax

Based on the 2018 budget, property tax currently funds 44 per cent of the operating budget which is within the acceptable range and has not changed significantly from last year.

g) Non-residential tax revenue is between 35 per cent and 45 per cent

Non-residential tax revenue is currently estimated at 36.7 per cent of the total operating tax revenue. Although this is within an acceptable range, the proportion of non-residential tax revenues has continued to decline over the past decade due to the changing nature of employment. The decline represents a decreasing proportion of property tax revenues from Industrial, Commercial and Institutional sector.

A continuing decline would put pressure on long term financial sustainability. The issue is being reviewed as a Term of Council Priority to plan and manage growth. The Region is currently developing an employment report to better understand the causes of the underperformance of non-residential growth and to develop strategies with local municipalities that can help to improve financial outcomes going forward. Additionally, socioeconomic research will be undertaken to assess implications of the changing nature of employment on Peel's fiscal sustainability.

h) Compliance with the Investment Policy

Based on a review of the Region's current investments, staff reports that the Region continues to be 100 per cent compliant with the Investment Policy. In 2017, Council endorsed a new Cash Management Strategy that will lead to improved investment returns and lower debt financing over time. Implementation is currently underway.
Flexibility:

i) Adequate Rate Stabilization Reserves – Tax

The balance of the Tax Supported Rate Stabilization Reserves as at December 31, 2017 is estimated at $161 million or 11.5 per cent of the 2018 Tax Supported Operating Budget, which is above the range of five to ten per cent as outlined in the Reserve Management Policy. The reserve level is retained pending resolution of the $211 million GO Transit liability, and may be utilized to reduce the need for tax supported debt for the Senior Health and Wellness Village.

j) Adequate cash to fund 12 months of debt payments

The Region’s annual debt payments (principal and interest) for 2018 are approximately $116 million. Sufficient cash is on hand to fund at least one year of debt repayments and protect Peel’s liquidity.

k) Adequate Rate Stabilization Reserves – Utility

The balance of the Utility Rate Stabilization Reserves as at December 31, 2017 is estimated at $37 million or 7.3 per cent of the 2018 Utility Rate Supported Operating Budget. The current balance is within the range of five to ten per cent as outlined in the Reserve Management Policy and is adequate to meet revenue volatility associated with weather patterns and electricity pricing.

l) Annual debt payments are less than 25 per cent of own source revenue

The Province imposes an Annual Repayment Limit on municipalities, which is 25 per cent of the net revenues for the municipality. Based on the most current Provincial estimate (2018), the Region’s net debt charges were 8.1 per cent of the net revenue, which is below the 25 per cent limit imposed by the Province.

The planned debt issuance for 2017 of up to $200 million for DC purposes was not required due in part to the work of the Growth Management Committee.

As a result of prudent planning and financial management, the Region of Peel is able to maintain its flexibility to issue debt and enable more options to advance the Region’s Strategic Plan.

3. Proposed Direction

Peel’s Long Term Financial Planning Strategy provides Council with a basis to inform decision-making. As mentioned earlier in the report, Peel’s environment is continually evolving. Key emerging trends such as demographic changes, changing nature of employment and changing economic environment could put pressures on Peel’s services and pose significant risks on the horizon. For example, an increasing immigrant population in Peel will increase the demand for immigration services; employment opportunities that are considered more precarious continued to dominate job growth in Peel and could
2018 ANNUAL UPDATE ON REGION OF PEEL'S FINANCIAL CONDITION

elevate low income risks and increase demand for social services; demand for affordable housing likely remains elevated with rising home prices; uncertain business environment due to NAFTA negotiations could negatively impact the local businesses in Peel.

To respond to the changing environment and to mitigate long term risks, staff is conducting a refresh of the Strategy. The refresh will include stakeholder consultations and an environmental scan to assess the impact of a changing environment and determine the relevancy of the financial principles and indicators currently used. In addition, a socio-economic research report on the impact of the changing nature of employment will be completed to provide additional insights to the refresh of the Strategy. Staff will report to Council on the results of the review and update in spring 2019. The Region continues to strive to ensure the long term financial sustainability of services, reduce vulnerability and remain flexible.

CONCLUSION

The Region of Peel's Long Term Financial Planning Strategy is an effective tool to guide Regional Council and staff decisions related to service and program planning in alignment with Region's Strategic Plan and Term of Council priorities. Financial policies and processes are providing a framework to help monitor, control and maintain the Region's financial condition. The 2018 Financial Condition Scorecard includes actions to mitigate longer term risks but overall, the Region of Peel continues to remain financially healthy.

Stephen VanOfwegen, Commissioner of Finance and Chief Financial Officer

Approved for Submission:

David Szwarc, Chief Administrative Officer

APPENDICES

Appendix I – 2018 Financial Condition Scorecard

For further information regarding this report, please contact Norman Lum, Director, Business and Financial Planning, 905-791-7800 ext. 3567 or via email norman.lum@peelregion.ca.
## 2018 Financial Scorecard

### Overall Financial Condition

- **Target**: High level credit rating
- **Assessment**: AAA credit rating reaffirmed by S&P and Moody’s

### Sustainability

- **Target**: 1–3% Net tax levy increase in line with inflation
- **Assessment**: On track
- **Summary of Action**: Continue 1.0 per cent infrastructure levy in 2019

- **Target**: 100% Adequate Capital Reserves – Tax
- **Assessment**: On track
- **Summary of Action**: Continue 5.0 per cent infrastructure levy in 2019

- **Target**: 100% Adequate Capital Reserves – Utility
- **Assessment**: On track

- **Target**: >70% Focus GTA Survey – Value for Tax
- **Assessment**: On track

### Vulnerability

- **Target**: <20% DC rate increase required
- **Assessment**: On track
- **Summary of Action**: Continue 1.0 per cent infrastructure levy in 2019

- **Target**: <50% of budget funded by property tax
- **Assessment**: On track

- **Target**: 35–45% Non-residential tax revenue
- **Assessment**: On track
- **Summary of Action**: Work with local municipalities to address changing nature of employment

- **Target**: 100% compliant with investment policy
- **Assessment**: On track

### Flexibility

- **Target**: 5–10% Adequate Rate Stabilization Reserves – Tax
- **Assessment**: On track

- **Target**: 100% Adequate cash to fund annual debt payments
- **Assessment**: On track

- **Target**: 5–10% Adequate Rate Stabilization Reserves – Utility
- **Assessment**: On track

- **Target**: <25% Annual debt payments as % of own source revenue
- **Assessment**: On track

### Legend

- [ ] On track
- [ ] Action Recommended
- [ ] No action required