Subject: Budget Planning Policy Review

Report to: Corporate Services Committee

Report date: Wednesday, June 12, 2019

Recommendations

1. That staff **BE DIRECTED** to prepare a Budget Planning By-law to replace the Affordability Guidance Policy that incorporates the recommended practices identified in items 1 through 6 of the Alternatives Reviewed section of Report CSD 41-2019; and

2. That staff **PROVIDE** a draft Budget Planning By-law to the Corporate Services Committee for consideration before the end of 2019.

Key Facts

- The purpose of this report is to propose a Budget Planning Policy and By-law to replace policy C-F-002 Affordability Guidance (previously C3-004) approved June 21, 2012.
- The policy is meant to establish principles and a framework to support staff and Council in building a budget that supports Council's business plan.
- This report provides research done by staff of other municipal policies and incorporates solutions to issues specifically effecting the Niagara Region.
- An updated policy cannot be prepared in advance of the 2020 budget however staff have highlighted items which can be implemented in the 2020 budget planning pending the completion of a By-law to be considered by Corporate Services Committee at a later date.

Financial Considerations

There are no financial impacts to the 2019 operations of the Region as the result of this report. Any changes to the principles applied by the Region within its policies will impact the preparation and approval of the 2020 and future budgets.

Analysis

A formal budgeting process is the foundation for good business management, growth and development. Niagara Region's current planning policy focuses on only one factor, the Core CPI target, whereas development of a budget has many influencing factors. The guiding principles and alternatives identified speak to concerns that Council and staff have identified in the past and incorporates policies other municipalities have implemented.

A number of guiding principles currently in use for the development of the budget should be incorporated into the by-law for common understanding and transparency. They are explained as follows:

- Differentiation between a Budget Planning By-law and the current Budget Control By-Law. The Budget Control By-law speaks primarily to the administration of the budget after it is approved (i.e. budget adjustments or amendments, etc.). There may be other edits required to the Budget Control By-law as the result of this by-law.
- Use of current year-to-date results (actuals). The new year budget is and always will be based on information available through the Q2 and Q3 Financial Updates. It will form the starting point for the next year's budget in addition to the analysis of trends and outcomes of the prior five years.
- Use of actual year end surplus or deficit. As per policy C-F-022 Operating Surplus/Deficit Policy, "The Niagara Region should not include in the current year's budget the surplus from a prior year." The surplus will be recommended for use in accordance with the above policy and reserve policy which may include transfer to the Taxpayer Relief Reserve which may be used in future year budgets for one-time items in a budget in accordance with the reserve policy. A deficit will be funded first from reserves to the extent possible, however it may be budgeted in the next year if required as supported by the Municipal Act.
- New known pressures and risks. Every year, the budget planning presentation includes information related to current year pressures that are on-going, costs associated with service level enhancement decisions made throughout the year, as well as pressures associated with new base service pressures impacting the budget year.
- Thresholds for program changes. Common understanding of what is considered a program change to be highlighted for council consideration should be established. These may be considered both for new program changes or base program changes. Staff would recommend that a dollar threshold be established; for example, the lesser of 10% of the division's net budget and $250,000. Additionally, program changes would be required as per policy C-HR-005 Corporate Delegation of Authority, "for the creation of a new full-time or part-time permanent position resulting in an increase in full-time equivalent, Regional Council authority is required."
- Budgeting for staffing complement. The budget for staffing complement is based on the prior year budget approved positions, adjusted for any collective agreement, compensation strategies, and benefit changes as determined in the budget preparation process. This will not make any assumption for the potential unknown vacancies that may occur in the budget year. A separate report and

policy will be prepared for Council consideration regarding the use of available funds from positions vacant in year (a gapping policy).

Options for Budget Planning

Staff have reached out to regional comparators within Ontario and explored other municipalities' policies to suggest updates to Niagara Region's current policy and methodology to plan for building the next year's budgets.

1. Base Budget Development
Historically Council has aimed to limit budget increases to the rate of inflation. A method of measuring inflationary impacts on our budget could be established as a guideline for staff and Council, however should not impede Council's ability to fund necessary costs of service, some of the options to measure the cost of inflation are as follows:

1.a. Use Core Consumer Price Index (CPI) Target
Current practice by the Niagara Region, targeting 2.0% inflation as identified by the Bank of Canada. The Bank of Canada updates the target every five years, most recently completed in 2016, applicable to December 31, 2021.

Pros

- Ties to a well known and highly documented inflationary factor with low volatility
- Seen as an affordable level of increase
- CPI target excludes volatile components that would cause fluctuations in the index

Cons

- Does not account for all types or quantities of goods and services purchased by a municipality
- CPI excludes volatile components which the Niagara Region purchases
- Specific price inflation in excess of CPI target requires reductions or cuts to meet guidance

Comparators
The Region of Halton, and Cities of Waterloo and Brampton utilize Core Consumer Price Index target.

1.b. Develop a Corporate Municipal Price Index (MPI) for Levy, Waste Management, and Water and Wastewater
A municipal price index 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. The Conference Board of Canada calculates an MPI for municipalities and their methodology and calculation for 2020 can be found in appendix 1. The corporate MPI under this methodology would be 2.6%.

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

Comparators

The Region of York and Cities of Calgary and Edmonton implement an internally generated MPI, supported by externally generated cost forecasts

1.c. Develop a separate MPI for Agencies, Boards and Commissions

Agencies, boards and commissions form 48% of the Niagara Region 2019 Levy, which prompted staff to review whether separate consideration should be taken towards the budgets of these entities. An MPI was identified as an opportunity to review this structure as unlike core CPI, it would fluctuate between these entities. As per appendix 1; this would be a 2.7% for Regional Departments and a 3.0% for ABCs.

Pros

- Same as those noted above for an MPI
- Supports better alignment of inflation factors to different services provided

Cons

- Same as those noted above for an MPI
- Impact on the consolidated levy will be the average of the amounts for regional departments, agencies, boards and commissions
- Agencies, boards and commissions may disagree with the factors or weighting applied by Regional staff

Comparators

The Region of Halton, while using CPI, separate increases between regional departments and police services.

Staff recommends options 1.b. and 1.c. as core CPI target is not indicative of the pressures we have seen in the past, therefore not likely a good indicator of the future. In order to come in at core 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. This option is being recommended for adopted in the development of the 2020 Budget Planning report.

2. Capital Financing

Funding for capital financing has been identified as an issue in the approved Asset Management Plan by GHD Ltd. And in the 2019 Capital forecast. A financial strategy to fund capital lifecycle is required under O.Reg 588/17 by July 2024; there is a risk of losing government funding if not met.

2.a. Separate Levy and Rate Increases

Staff have recommended in the past that a separate budget increase be considered, a 1% was approved in 2017 and has remained in the base budget. Based on the 2019 9-year capital forecast, a 1.3% increase was recommended as an annual increase for the next 10 years.

Pros

- Allows for gradual increases over a longer period of time
- Easily tracked and maintained through use of the Infrastructure Deficit Reduction reserve fund
- Transparent approach that is based on the 9 year forecast, with integration from the Asset Management Plan
- Flexible and sustainable funding source

Cons

- Project deferrals could impact immediate requirements
- Until the Asset Management Plan is fully implemented full capital needs may not be as accurate as anticipated

Comparators

This method is implemented by the regions of Waterloo, Peel, York and Halton

2.b. Incorporate into MPI

The current policy methodology of using CPI target does not properly reflect capital renewal costs as an inflationary factor. By implementing the MPI as referenced above a weighting for capital financing can be incorporated.

Pros

- If implementing an MPI capital financing can be addressed within base requests
- Will be applied as a standard across Levy, Waste Management and Water and Wastewater

Cons
- More administratively intensive to apply inflation factor to capital
- Inflation factors applicable specifically to Niagara Region's capital program will not all be available
- May lead to significant volatility in the MPI as capital needs vary year over year

Comparators
Municipalities that take an MPI approach utilize Bank of Canada prime lending rate as an inflation factor for capital

2.c. Assessment Growth apportionment to Capital Reserve
Capital projects added as the result of growth or Council Priorities require a sustainable funding source. The costs of these projects not eligible to be funded by development charges represents a cost of growth requiring funding through other methods.

Pros
- No impact on existing taxpayers, supporting taxpayer affordability
- Promotes intergenerational equity where capital projects required as the result of growth are funded by assessment growth
- Easily tracked and maintained through reserve funds

Cons
- Portion of growth costs are already funded through development charges charged on new properties
- Assessment growth is only calculated for the Tax Levy, this option will not address the gap in Water and Wastewater infrastructure
- Assessment growth funding fluctuates year over year

Comparators
The City of Waterloo applies 40% of assessment growth funding to capital programs

Staff recommend options 2.a. and 2.c. Through the use of two options, taxpayer impact will be reduced and increases will be clearly identified and traceable; staff have identified to Council the projects the 1% Infrastructure Deficit reserve have funded since its inception in 2017. This option should be incorporated into the 2020 Budget.

3. Assessment Growth

Assessment growth is the sum of all changes that happened to the Region's tax base as a result of new constructions, expansions, demolitions, and change-in-use of property. The increase in tax base compared to the prior year is the assessment growth. Regional taxes can increase by this amount without burdening current properties. Over the last five years assessment growth has averaged 1.3% or $4.2 million.

3.a. Use of growth funding for Tax Increment Grants (TIGs)

Planning and Economic Development offer a tax rate rebate program, for a percentage of the post-project values, promoting growth within the region. Full taxes are still billed by the Region to the local area municipality and subsequently returned through grants. These grants require a source of funding.

Pros

- Grants reducing taxes payable be paid by tax growth from those properties
- Transparent in identifying the impact of offering TIGs

Cons

- Other programs may be seen as more deserving of growth funding
- Deferral of benefit of growth funding until the grant is completed

Comparators

Current Niagara Region practice since 2017. Comparable municipalities have identified these costs as grants within a defined program; the Niagara Region has entered into contracts for amounts beyond the current budget and are unable to meet obligations without increasing the budget considerably as properties are constructed.

3.b. Operating and Maintenance Costs of New and Growth Capital

New capital assets added as the result of growth come with operating costs of their own. As an example, if three new ambulances are added through the capital budget, additional paramedics are required to staff them.

Pros

- Assessment growth funds the operating costs of growth, promoting intergenerational equity
- Costs related to growth are not borne by the base budget, therefore not requiring cuts to service

Cons

- Funding may not be available after prioritizing other programs

Comparators

Other municipalities did not make specific mention of use of growth.

3.c. Assessment Growth apportionment to Capital Reserve
See option 2.c. above

3.d. Growth Incentives
A suite of incentive programs that encourage growth through the region are offered through Economic Development and Planning and Development. The result of these programs is increased growth in future years, as well as other benefits of the programs, such as job creation, aesthetics, etc.

Pros

- By increasing incentives, more growth funding would be recognized in following years, leading to a compounding effect of reinvesting
- Promotes job growth

Cons

- Cost of these programs are not as the result of growth, and could require cost increases be borne by base services
- Any growth funding derived from incentive programs would not be realized until years later
- Efficiency of incentive programs may not lead to 1:1 returns

Comparators
No other municipality had made specified mention of funding growth incentives with assessment growth.

3.e. ABC requests for assessment growth funding
Current methodology for sharing growth with ABCs applies an increase to base budget development, inconsistent with practices of growth paying for growth. Another option available is for ABCs to submit business cases similar to other departments.

Pros

- More transparent than current practice
- Supports collaboration between the Niagara Region and ABCs
- Funding is not apportioned towards base service costs

Cons

- Budget schedules of the ABCs might not align with Niagara Region
- Prioritization may not meet expectations

Comparators
Other municipalities did not make specific mention of share of growth funding.

Staff are supporting all options (3a. through 3.e.) in an order of priority. Items identified as the result of growth (3a. and b.) would be prioritized over items funding growth (3.c.

and d.). This follows the principle of growth paying for growth, supporting costs of growth first being financially responsible, and reinvesting into growth with what remains.

4. New Programs

From time to time new programs supported with business cases (as per the guiding principles to be established in the policy) are requested and/or proposed by staff to address a public need, strategic priority, leveraging of an opportunity etc. These costs have historically been funded from assessment growth or reductions in other base budget spending. It is being recommended in this report that assessment growth be reserved to fund other initiatives therefore new program funding options are identified below:

4.a. Separate Levy and Rate increases above Base Budget Development

Any requests for new programs or services are known in advance of budget approval. Early estimates are provided to Council during budget planning to identify need and plan for increases in excess of base budget development. This is the process used for Canada Summer Games and Niagara Regional Transit.

Pros

- Tax impacts of new programs are transparent
- Base services are not impacted through reductions in spending to accommodate new programs

Cons

- Tax increases will be above the rate of inflation

Comparators

City of Brampton and Region of Halton identify new services and separate funding requirements

4.b. Incorporate into MPI

Through the development of an MPI (new program funding envelope) Council has the flexibility to add a percentage to be set aside for new initiatives.

Pros

- Allows staff flexibility in developing new programs or services for the new year
- Simplifies budget approval through fewer recommendations for new programs

Cons

- An amount added to base services may be unable to fund larger initiatives
- Council may be less involved in decisions leading to new program approval

Comparators

Municipalities that take an MPI approach did not note how new programs are incorporated into their budget development

4.c. Growth funding

Historical treatment by the Niagara Region has been to fund new services through assessment growth to reduce taxpayer impact. New programs can be drivers of growth, by offering new services to the community.

Pros

- No impact on existing taxpayers, supporting taxpayer affordability
- Base services are not impacted through reductions in spending to accommodate new programs

Cons

- Growth funding is finite, limiting program enhancement opportunities
- Growth has been identified for other priorities, i.e. growth capital, economic incentives

Comparators

No other municipality had made specified mention of funding new programs with assessment growth.

Staff recommend option 4.a. so we do not impact the public's expectations of current service levels and set up the Region to properly provide new services as they are implemented. This option is being implemented in the 2020 Budget Planning report.

Alternatives Reviewed

Staff have identified recommendations that Committee could adopt through this report for the development of a Budget Planning By-law.

1. That Base Budget Development be in accordance with option 1.b., using a Corporate Municipal Price Index (MPI) for Levy, Waste Management, and Water and Wastewater.
2. That Base Budget Development for the Agencies, Boards, and Commissions be in accordance with option 1.c., using a separate MPI from Levy Departments.
3. That capital financing be addressed through option 2.a., using separate levy and rate increases above Base Budget Development.
4. That capital financing for new or growth projects be addressed through option 2.c., apportioning assessment growth funding to capital reserves.
5. That the budget for new programs be presented to Council for funding through option 4.a., using separate levy and rate increases above Base Budget Development.
6. That assessment growth funding be apportioned to items in options 3.a. through 3.d., as identified annually by Regional Departments and Agencies, Boards, and Commissions through option 3.e., prioritized as follows:
    a. Funding for Tax Increment Grants

b. Maintenance costs of capital
c. Apportionment to Capital Reserves
d. Growth incentives

Council could identify other combinations of options as identified throughout this report.

Relationship to Council Strategic Priorities

The suggestions in this report are for implementation in a control document to follow, and will support operational excellence.

Other Pertinent Reports

CSD 40-2019 2020 Budget Planning

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Appendices

Appendix 1 Municipal Price Index