TO: City Council

FROM: Mayor Lehman

RE: 2021 Budget

DATE: January 18, 2021

Members of Council this memo lays out a series of proposed changes to the budget to accomplish two primary goals:

- reducing the tax increase for 2021 and earmarking funds to offset the 2022 increase
- changing the funding mix in our capital plan to reduce borrowing costs and potentially advance strategic projects.

I'm also recommending to Council that we pursue several new fiscal measures for 2021 that will help with COVID recovery, specifically small business tax relief and a support program for water customers who can't pay their bills.

I decided to write this down this year because there are a number of unusual circumstances affecting the budget that I think we need to consider. These include COVID-19 costs, economic conditions, and the interest rate environment. Each of these merit different budget responses than in a typical year.

Reducing the Tax Increase

It's clear that this is not the year for a significant tax increase, and our residents are currently facing a new and deeper round of economic uncertainty due to the pandemic. While City finances are similarly at risk, staff did an excellent job of managing costs in 2020 and have positioned us well to flex with fiscal impacts in 2021.

I wanted to review and recommend some of the larger dollar moves that can be made to bring down the increase. Several of these were already listed by the CAO in his suggestions to Council. I'm not including here a review of the New Investment Recommendations or the detailed department or service partner spending in their base budgets, instead focusing on the larger dollar changes.

I would propose to do the following to lower the tax increase:

- Apply Safe Restart Funding to offset service partner and corporate costs due to COVID
- Fund the Growth Strategy from BHHI Dividends and the Tax Rate Stabilization Reserve
- Reduce the DIRF from 1.0% to 0.25% in 2021, and set a target of 0.5% in 2022
- Remove the additional operating budget contribution to the Fleet Replacement Project
- Create a two-year strategy to reduce tax increases by applying a portion of the 2021 and 2022 BHHI dividends to the operating budget, and draws on the Tax Rate Stabilization reserve

To provide further if modest relief to our residents, I would propose freezing wastewater rates for 2021.

The overall impact of these proposed changes would be to reduce the tax increase to 0.7%, and reduce by a little over 50% the proposed increase in water/wastewater bills, resulting in an increase of about 1.1% to the average water bill in 2021 instead of the proposed 2.4%.

Safe Restart Funding

Staff are proposing a 2021 budget that reduces compensation costs at the City, primarily as a result of temporary reductions due to COVID-19. Certain service costs are also reduced for the pandemic, such as transit service hours. At the same time, City revenues are forecast to drop by $5.7M due to the pandemic. While new growth will offset some of this revenue loss, the overall fiscal impact is negative.

The County has increased its ask to fund provider loans to social housing providers, and the City's balance for Major Financed Capital projects will be $19M this year, a substantial liability. This can only be brought down over time with increased reserve contributions, so I don't agree with eliminating the increase to the County reserve this year. However, as a number of the costs being passed on to the City are one-time increases associated with COVID, such as the substantial jump in LTC costs, it's appropriate to apply the Province's Safe Restart Funding to this increase as well.

The Police have also had one-time costs due to COVID. At the time of writing, staff are investigating the use of Safe Restart Funding against both 2020 and 2021 costs for the police.

We should apply the 2021 Safe Restart Funding against these costs, in the amount of $1.3M.

Net impact on tax based budget:

- **Safe Restart Funding - $1,300,000**

Fund the Growth Strategy from BHHI Dividends and the TRSR

Per the email from staff, the funding of the Growth Strategy from a combination of the BHHI dividends and the Tax Rate Stabilization Reserve is possible. The risk associated with this is that the longer operating funds are not used to support these costs, the longer it will take to fund new services associated with growth. However, growth is occurring more slowly than planned. Increasing each reserve contribution to fully fund the $2M growth strategy will reduce the tax levy by $500,000.

Net impact on tax based budget:

- **Additional BHHI and reserve funding - $500,000**

Reduce the Dedicated Infrastructure Renewal Fund

I would propose to reduce the DIRF from 1.0% to 0.25% in 2021 and set a target of 0.5% in 2022.

One of Council's major accomplishments in the last decade was increasing spending on infrastructure renewal, such as fixing roads, and reducing the infrastructure deficit. Spending on road renewal is more than 8x what it was before the DIRF was implemented, and this was in direct response to our residents, who told us that the condition of roads, and the traffic resulting from capacity constraints (think Mapleview!) was their #1 concern regarding infrastructure. However, the cost of this increase has been a 1% levy on tax bills for the past 6 years.

Given the economic uncertainty around the pandemic, which will likely continue into 2022, slowing the implementation of the DIRF can provide some relief. However it should be noted that this will result in delaying the delivery of projects funded by the Tax Capital Reserve if alternative funding is not delivered (see part 2 of this memo). And as the impact of any cut is felt not just in the year it is made but results in reduced revenues for every year going forward, I would propose to not eliminate the DIRF for these two years entirely but reduce it instead. Note that the reduction will require recalibrating future years of the capital budget funding or pushing out projects – although this could be offset by the debt strategy identified below.

Net impact on tax based budget:

- **Levy reduced to 0.25% = $1,880,000 reduction in 2021 levy**
- **Target – reduce to 0.75% in 2022 = $625,000 reduction in 2022 levy**

Remove the operating funding for the Fleet Replacement Project

The Fleet Replacement Project will require, over time, a sustainable annual contribution from the Tax, Water, and Wastewater operating budgets. I see this project as an excellent example of how to reduce costs by proper maintenance – the City is currently wasting hundreds of thousands of dollars keeping vehicles on the road with emergency repairs, when financed or purchased vehicles would not incur these costs.

As the project has started slower than planned, staff have indicated that the tax operating budget contribution can be deferred again this year. That said, as borrowing rates are at record lows, and the potential exists to reduce operating costs through faster, I would propose that staff investigate the potential to save taxpayers money through faster implementation of the Fleet Replacement Project using financing, if fiscally responsible. More on this below.

Net impact on tax based budget:

- **Reduce reserve contribution by $460,000**

Apply BHHI Dividends and Tax Rate Stabilization Reserves to offset tax increases in 2021 and 2022

It's also possible to reduce the tax increase in any given year using one-time funding. However, I see this is not as fiscally responsible as an ongoing strategy as it simply creates a larger "hole" in the budget in future years. If the City's revenues do not keep up with costs, there is an ever-growing gap that needs to be filled with reserve funds, which will be quickly depleted. This is not sustainable or wise. If we wish to do this, we should 1. Use a recurring funding source, in the event that Council does not wish to "make up the difference" in one year and 2. Earmark funds to cushion the blow for 2022 – create a "ramp up out of the hole" that will avoid taxpayers being hit with these costs next year.

The BHHI dividends are a reasonably-solid annual funding source, and are the best-performing investment the City currently holds. While there are certainly risks around the dividend stream, they have consistently been delivered above plan, although 2020 and 2021 are likely to be below plan due to the pandemic.

Council has wisely, in my opinion, committed these funds to strategic projects such as economic development and affordable housing through the Reinvestment Reserve. However, as several of the projects have been delayed or are being rethought, the 2021 dividend stream is unlikely to be needed to be committed to the reserve this year or next in its entirety (page 45 of the budget binder).

I would propose to apply $1.75M of the BHHI dividend to the tax operating budget in 2021 and earmark an amount of $1M for 2022 to create a "ramp" for next year.

Further, the Tax Rate Stabilization Reserve exists for the purpose of reducing higher than normal tax increases due to unforeseen circumstances. Certainly, COVID is one of those circumstances, although as noted before there is no guarantee that revenues and costs will normalize in 2022 to an improved fiscal position. I would propose to apply $1.25M in TRSR funding to the 2021 budget and earmark $1.0M for 2022, to offset anticipated pressures. To be clear this is not an ongoing funding source and unless replenished at year end, represents a one-time funding choice that will leave an impact on future budgets.

Net impact on tax levy:

- **Reduction of $1.75M through BHHI funding**
- **Reduction of $1.25M through TRSR funding**
- **Earmark $1.0M of BHHI funding to offset 2022 tax increase**
- **Earmark $1.0M of TRSR funding to offset 2022 tax increase**

Total impact on tax levy:

- **Safe Restart Funding - $1,300,000**
- **Growth strategy reserve funding - $500,000**
- **DIRF reduction - $1,880,000**
- **Fleet replacement funding deferral - $460,000**
- **BHHI funding - $1,750,000**
- **TRSR funding - $1,250,000**

Net = Reduction of $7.1M

Tax Increase = 0.9%

Freeze Wastewater rates

Water and wastewater rates are proposed by staff to increase by 2.48% and 2.41% respectfully. While this is only a $21 total bill impact in 2021, in my opinion the wastewater rate impact could be managed if 0%. The water and wastewater budgets are built to generate substantial reserve contributions to pay for capital projects. This reserve is in relatively good condition and as only roughly $650,000 of the $1.5M additional revenue is due to the rate increase (the other $850,000 results from growth), there will still be an increase of $350,000 in the contribution to reserve even if rates are frozen. This reduces the increase in the overall bill to $9 annually, or 75 cents a month.

Many utilities have programs to assist individuals who struggle to pay their bills. In 2020, Council provided relief on one bill cycle to help residents during the first lockdown. Currently, arrears on water/wastewater bills have been rising and the average resident's bill has risen with kids being home from school and more people working from home. Council could direct staff to create a low-income support program, similar to those in place at electric companies and gas companies, to assist those in financial need. Alternately, we might look at a delayed billing process similar to the relief provided in 2020.

Small Business Tax Reduction

The Province has provided the ability to create a new tax class for small business, to allow them to receive a lower property tax rate. While there are many details to come on this, I believe it would be appropriate

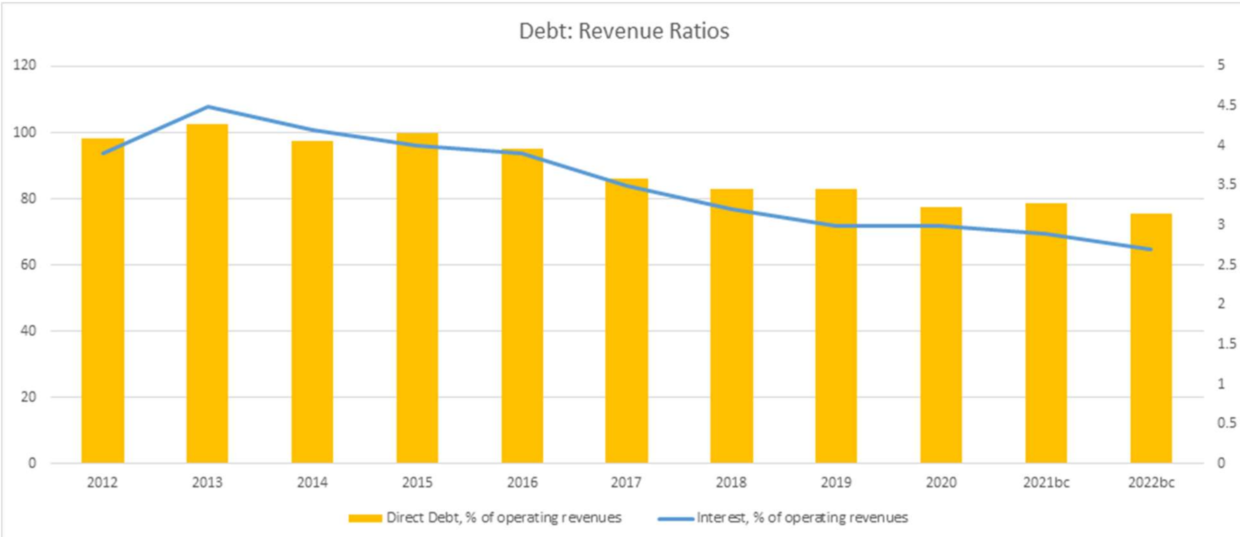
A key issue will be whether this new tax classification shifts substantial additional costs on to homeowners. While a discount that applies to a relatively modest number of lower-cost properties would likely not cause a significant tax shift, this relief program will need to be carefully designed so it does not burden homeowners.

That said, it creates the potential to incentivize startups and small businesses at a time when this is needed. Barrie's small business community has borne the brunt of COVID lockdown impacts and would very much value the support.

Council could direct staff to prepare a plan for implementing a small business tax subclass including assessing its financial impacts for both benefitting businesses and all other tax classes, and report back to Finance or General Committee.

Part 2 – Capital Plan Financing

One of Council's most important accomplishments during the past decade was the reduction in the ratio of debt to revenues at the City. This is a critically important metric as it affects the City's credit rating, which determines our interest rates and costs. Interest costs as a percentage of our operating revenues have dropped over ten years from a high of about 4.5% of operating revenues to 3.0% in 2020, according to S&P and are forecast to continue to drop for the next two years as well. However, the debt requirements of our capital plan increase in the outer years, which will create pressure at that time, if the capital plans remain as forecast.



These reductions have occurred in the context of interest rates that have gradually dropped. Today's borrowing rates are at historic lows. In November, I emailed Council with details regarding our placement of $10.25M in debentures associated with the First Responders Campus project. That debenture was issued at an interest rate of 1.3%, resulting in interest costs of just $70,000 on average annually over the term. Rates have dropped by more than 1% since pre-pandemic, and as a result the interest savings on this debenture alone are roughly $1M to the taxpayer over the course of the term.

To put this in perspective – if the City issued $50M in 10-year debt, it would pay a total of just $3.5M in interest costs over ten years, instead of roughly $7M at 2019 rates. If this is planned debt, these are savings to the capital plan; if it is a combination of new debt and planned debt, the City could undertake additional projects today without impact on the overall interest costs of the capital plan, relative to 2019. However, we would be increasing the city's overall debt total.

I'd propose that as a consequence of this very low interest environment, it is an opportune time to advance some capital spending if these record-low rates can be secured. This could produce millions in savings for our residents, and allow us to proceed more swiftly with both needed growth and renewal projects, as well as delivering on key strategic priorities such as economic development, affordable housing, and population health.

In order to do this, I would suggest that our staff develop a series of scenarios that outline the fiscal impacts of accelerating planned debt issuance AND the issuance of a modest amount of additional debt, and report back to Finance and Corporate Services Committee by March of 2021. The direction would be to identify projects planned to be funded using the Tax Capital Reserve within the ten-year capital plan that could be accelerated or funded differently, and further, to identify a funding envelope for strategic projects that support the priorities of economic development, affordable housing, and population health that could be accelerated using this strategy. To this end, I would propose that staff look to advance or expand capital spending in the areas of:

- Economic development and job creation, such as servicing employment lands and the West End
- Affordable Housing funding, including County projects in their capital plan, or our CIP's
- Population health, focussing on proactive measures to reduce calls to emergency services

There are two risks in this: first, that increased debt could affect our credit rating. While recognizing our efforts to reduce debt and limit it going forward, S&P warns about this in our annual report. Adding or accelerating debt must not occur at the expense of a credit downgrade, which would drive up our borrowing costs. Key here is not growing debt faster than total revenues – the lines on the chart above needs to stay flat or very close to it. Ideally, I would see our debt:revenue ratio continuing to drop, even if we accelerate some debt from latter parts of the plan.

Second, the additional debt charges will impact the tax based operating budget, if the projects are tax funded. I would propose that we identify the Reinvestment Reserve funding to carry these costs, if needed, for any new strategic projects that are undertaken. In this way, we would leverage the BHHI dividends for strategic projects, as was intended. So, if Council chooses to advance say $20M in economic development projects, affordable housing funding, and measures to reduce emergency service calls, the roughly $2.15M in annual debt service costs (10 year debt) or $1.2M (20 year debt) could be carried by the Reinvestment Reserve, funded by BHHI dividends.

I firmly believe our kids will thank us (if they were bored enough to read historic municipal budgets)!

All of this is submitted for Council's consideration.