Region of Peel
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REPORT
Meeting Date: 2023-06-22
Regional Council

For Information

REPORT TITLE:	**2023 Update of the Region of Peel's Financial Condition**
FROM:	Patricia Caza, Chief Financial Officer and Commissioner of Corporate Services

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" credit ratings was reaffirmed by Standard & Poor's Global Ratings and Moody's Investors Service in 2022, making Peel one of five Canadian municipalities to hold a dual Triple "A" credit rating.
- The Financial Scorecard shows that the Region is within acceptable ranges for six of the ten financial indicators. Recommended actions for all ten indicators are included in Appendix I.
- The 2023 Financial Scorecard includes actions to mitigate longer term risks to ensure the Region remains financially healthy.
- Conditions in the overall economy changed rapidly in 2022. The post-pandemic economic rebound was interrupted by several factors, and both inflation and interest rates increased to multi-year highs creating unprecedented macroeconomic uncertainties.
- The Region's overall good financial state will be leveraged to mitigate the impact of the changed economic environment on critical services to the community as well as the financial impact to its residents and business community.
- The Region continues to advocate for external funding to address emerging challenges, contribute to economic expansion and safeguard Regional fiscal sustainability.
- With Bill 112, the *Hazel McCallion Act (Peel Dissolution), 2023*, receiving royal assent, there will be longer term financial implications that will need to be assessed once the Transition Board is in place.

DISCUSSION

1. Background

In 2013, Regional Council approved the first Long Term Financial Planning Strategy (the "Strategy") to address the increasing financial pressure from Peel's growing population and evolving economy on its services and programs. The Strategy provides a long-term perspective to guide decision making in support of the Region's overall financial condition and demonstrates the required balance between financial sustainability, financial vulnerability and financial flexibility.

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

Typically, an annual update is provided to Council on the Region's overall financial health under the principles of the Long-Term Financial Planning Strategy and on its Financial Condition Scorecard including recommendations from the prior year.

The Strategy and Scorecard continue to help identify and prioritize the resources needed to achieve strategic objectives by managing the Region of Peel's financial sustainability, vulnerability, and flexibility. These principles along with complimentary internal monitoring have allowed the Region to maintain its Triple "A" credit ratings and be one of five Canadian municipalities to hold a dual Triple "A" rating from Standard & Poor's Global Ratings and Moody's Investors Service.

Impact in 2022 – A Rapidly Changing Economic Environment

The 2022 report comes amidst a rapidly changing economic environment. The heightened geo-political tensions due to the war in Ukraine, supply chain challenges, multi-decade high inflation rate and rising interest rates have increased costs and created unprecedented macroeconomic uncertainties. This will have significant impacts at all economic levels, including in Peel, with repercussions for resource costs related to Regional capital projects, business operations and greater demand for some Regional services, due to enhanced affordability challenges that are confronting many vulnerable residents.

a) Status of the 2021 Financial Scorecard Recommendations

The last financial scorecard reported to Council was on April 22, 2021. To summarize, the 2021 Financial Scorecard indicated that the Region had maintained its overall strong fiscal health and included the following two recommendations to further strengthen its' financial condition:

- Include a 1.0 per cent tax supported infrastructure levy and a 5.0 per cent utility rate infrastructure levy in subsequent budget years to mitigate sustainability risks in the long term.
- Assess the impact of Provincial funding and support Council's advocacy efforts.

Infrastructure Levy
The recommended 1.0 per cent tax supported infrastructure levy and 5.0 per cent infrastructure levy for utility rate supported programs were both approved as part of the 2022 and 2023 Budgets.

Impact of Provincial Funding
In 2019, the Province of Ontario revised Provincial funding formulas which changed how the cost of services are shared between the Province and the Region. These changes effectively transferred costs to the Region of Peel.

In 2022 and 2023, Council directed the inclusions of $2.9 million and $1.9 million respectively, to replace some of the funding shortfalls with property tax dollars to ensure service levels were maintained. Details for 2023 are provided in the Reliance on External Funding section 2b) ii) below.

To help mitigate the impact to the taxpayer, staff have continued to review regional services for cost containment options that have minimal impact on service delivery and additional focus was placed on identifying efficiencies throughout the organization. The 2023 Budget reflected the continuance of some of these changes.

Staff will continue to monitor, assess and leverage federal and provincial funding opportunities that support community and organizational outcomes, including infrastructure investments that support economic recovery.

2. 2023 Financial Scorecard

Staff assessed the Region's current financial condition using the financial performance indicators on the Financial Scorecard (Appendix I). The scorecard shows that the Region is within acceptable ranges for six of the ten indicators and actions are recommended for all the 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 ratings are as follows:

a) Financial Sustainability

i) Net Tax Levy Increase

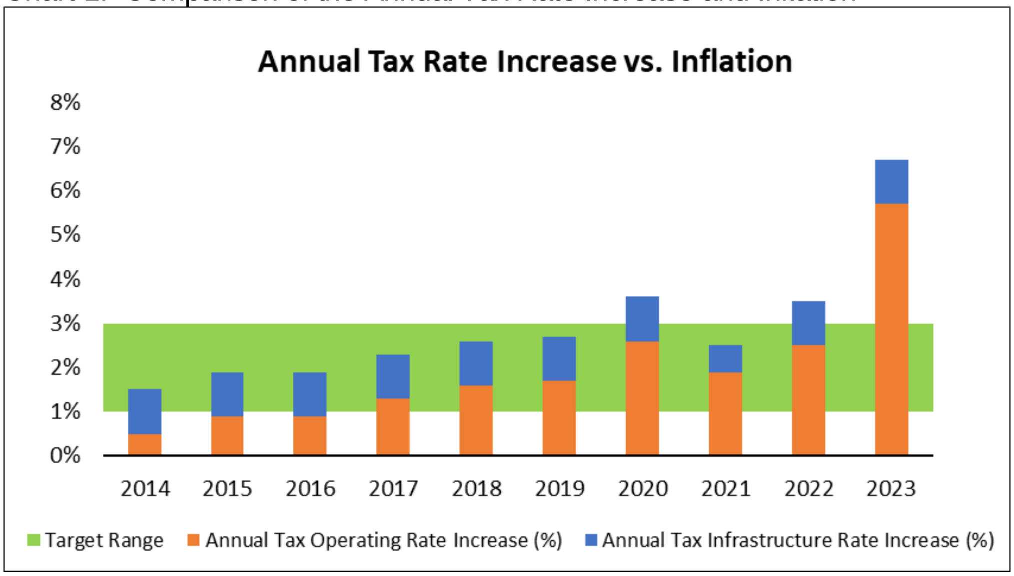
Since the implementation of the Strategy in 2013, the net annual tax levy increase has averaged 2.9 per cent which falls within the Bank of Canada inflation target range of 1 to 3 per cent. A net levy increase of 6.5 per cent was forecasted for 2024 in the 2023 Budget, which includes estimated provincial funding impacts and includes a 1.0 per cent infrastructure levy to sustain the state of good repair of Peel's assets and a 1.0 per cent Community Safety levy for the Peel Regional Police to finance the police facilities proposed through the 2023 Capital Budget.

Since the development of the 2023 Budget Forecast in late 2022, Canadian inflation has accelerated to a 40-year high, and while it is expected to fall from its 2022 peak, it will likely remain elevated in 2023, and return to more normal inflation levels afterwards. Additional information on the impacts of heightened inflation were provided through the June 23, 2022, report of the Commissioner of Corporate Services and Chief Financial Officer titled "Overview and Impacts of Heightened Inflation on Regional Services".

Consistent with the principle of "Respect for the Taxpayer" within the Long Term Financial Planning Strategy, net tax levy increases that are in line with the Canadian Price Index (CPI), generally between 1 and 3 per cent are recommended. However, as inflation is expected to remain elevated for 2023, achieving a net tax levy in line with inflation may result in an increase higher than the normal 3 per cent upper range as outlined in Chart 1 below.

Staff have brought forward a separate report to Council with recommendations on the development of the 2024 Budget during this period of heightened inflation and economic uncertainty.

Chart 1: Comparison of the Annual Tax Rate Increase and Inflation



ii) Capital Reserves as a Percentage of 20-Year Capital Plan

As Council has approved increases to the annual contributions for both the Tax Supported and Utility Rate Supported capital reserves, the sustainability of capital reserves to meet future capital requirements has improved. Unfortunately, the overall 20-year capital plan continues to experience a funding shortfall. The past five years showing this shortfall are outlined in Chart 2 below.

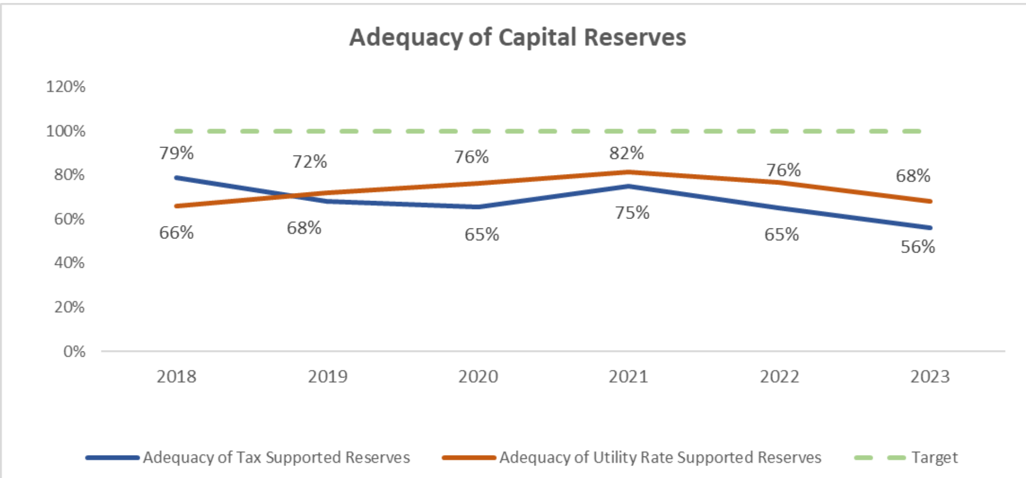
Based on the most recent reserve adequacy assessment carried out during the 2023 Budget process, current Tax Supported reserve levels and contributions have a $3.2 billion shortfall compared to the forecasted 20-year (2023-2042) capital requirements including the social housing stock. To address the long-term Tax Supported capital requirements, a one per cent infrastructure levy was included and approved in the 2023 Tax Supported budget, which represents an increase to the annual capital reserve contribution of approximately $12.3 million. For the years 2024 and beyond, a one per cent infrastructure levy will continue to be needed to sustain the tax supported capital plan and there is sufficient funding to ensure the state of good repair of infrastructure.

Based on the most recent assessment of the Region's water and wastewater infrastructure during the 2023 Budget process, approximately $8.2 billion will be required over the next 20 years to predominately finance the state of good repair of water and wastewater assets. This level of investment will maintain current service levels to the public and manage infrastructure risks. To mitigate the current unfunded shortfall of $2.6 billion, an increase to the utility rate of 5.0 per cent for infrastructure or $22.6 million was included and approved in the 2023 Utility Rate Supported budget. Analysis shows an annual increase of 5.0 per cent from 2023 to 2027 will close the current funding gap.

However, as explained in the March 9, 2023 report to Council, Infrastructure Planning and Requests of the Province to Support Bill 23 Housing Targets, the water and wastewater and transportation infrastructure required to achieve the Province's new housing targets for Peel's municipalities is more than double the $8.2 billion mentioned above, at an estimated cost of $20.4 billion. These costs do not include debt servicing costs, the impact of inflation, land acquisitions, other soft costs or any estimated loss in DC revenue projected to be around $2 billion.

The reserve adequacy gaps may also be widened due to the impacts of higher inflation on key commodities and resources required for capital work. Staff are currently re-assessing Peel's capital requirements and will be making adjustments through the 2024 Budget.

Chart 2: Historical Trend of the Funding Shortfall of Capital Reserves



iii) Asset Health Score

The current overall status of the Region's infrastructure state of repair is "Good" as a result of ongoing capital programs to replace outdated and deficient assets with new modernized infrastructure. However, the reinvestments necessary to maintain the service levels that the public expects continue to increase. This is largely driven by aging infrastructure, growing climate change impacts and uncertainty, additions of infrastructure to address growth and any Council priorities, as well as renewed data and information on the existing infrastructure. To ensure that the Region's infrastructure is maintained, assessed and supported, it is recommended that the Region continues to mature its current asset management program and that Council continues to proactively fund the growing infrastructure needs.

b) Financial Vulnerability:

i) Reduction in Growth Related Risk

As a result of statutory changes brought about by provisions in Bill 23, the *More Homes Built Faster Act, 2022* (Bill 23), Peel's responsibilities related to land use planning are to be removed on a date to be proclaimed by the Lieutenant Governor. While Bill 23 will remove Regional planning responsibilities, there continues to be a strong need for regional growth management to coordinate growth and infrastructure provision across Peel and to identify and mitigate financial risks associated with growth.

The changes imposed by Bill 23, which include significant reductions to the Peel's ability to collect development charges, along with continuing systemic challenges associated with development charge revenue collections, required capital expenditures to support growth, and cost escalation pressures will result in increased debt requirements for Peel. Increased debt requirements for growth-related infrastructure will put pressure on the Peel's capacity to utilize debt for future growth and non-growth-related capital. Furthermore, increased debt reduces the Peel's financial flexibility as a higher percentage of development charge revenues is directed to support debt service costs.

In 2015, Plan and Manage Growth was approved as a Term of Council priority which focused on Peel's debt levels associated with development charge revenues and expenditures, also known as the cost-revenue gap. Since 2019, planning, managing, and servicing growth continues to be a key organizational priority. The integrated Growth Management Strategy has provided greater flexibility in managing expenditures and enhancing revenue.

ii) Reliance on External Funding

The Region is mandated to deliver many Provincial programs such as Child Care, Housing Support, Ontario Works, Paramedic Services and Public Health. Provincial funding is a key source of revenue to offset municipal costs in delivering these services, as it represents approximately twenty-eight per cent of the Region's overall operating revenue as shown in Chart 4 below.

The Region has budgeted receipt of $864 million in external funding from upper levels of government for 2023 towards this purpose. This amount represents a $240 million increase from the funding levels in the 2022 Budget, largely driven by a $213 million increase in childcare funding to implement the federal $10 a day daycare program and an increase of $8.7 million in funding from the province to implement the four hours of care program in the long-term care homes.

While the funding of new programs by the federal and provincial governments provides more support for parents and seniors in Peel, funding in other key areas remains inadequate to the service delivery demands being placed on Peel.

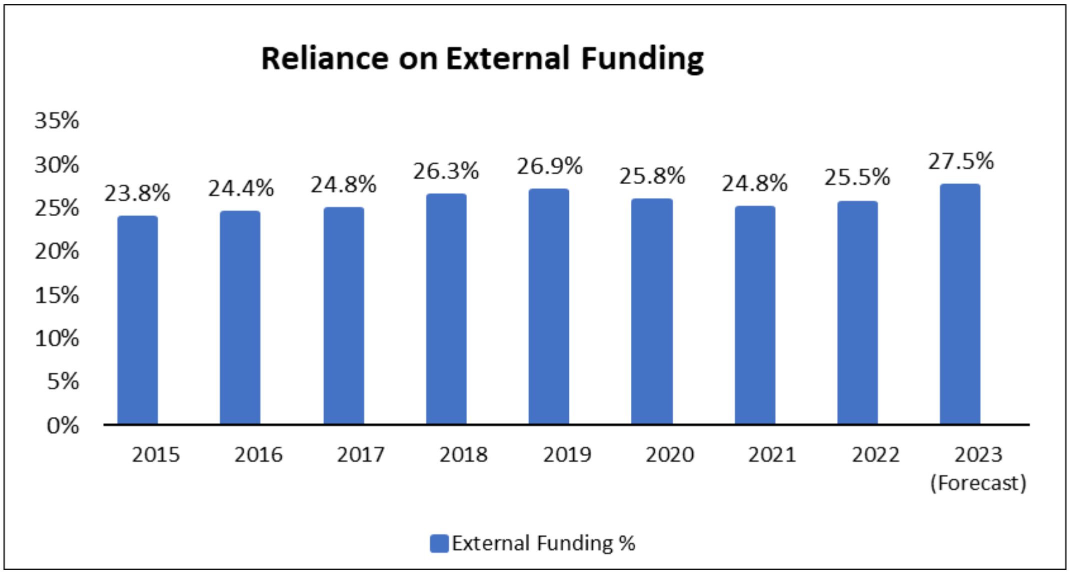
As discussed above in 1. a) in the Provincial Funding Impact section under the Status of the 2021 Financial Scorecard Recommendations, an investment of $1.9 million in property tax dollars was included in the 2023 Budget to replace part of the funding reduction to maintain core service levels in impacted services.

Provincial funding for Public Health's mandatory programs have remained almost stagnant since 2018. In April 2022, the Province provided a one per cent increase to the mandatory funding for Public Health. However, this funding was insufficient to fund the year over year inflation leaving a gap of $1.2 million for 2023.

In Housing Support, the Province reduced housing transfer payments by $0.7 million as published in the Ontario Gazette.

Continued advocacy is critical to ensure that costs for provincially mandated programs do not continue to be transferred to the Region. Predictable and sustainable funding is necessary to support the successful delivery of key services to Peel's residents.

Chart 4: Historical Trend of percentage of External Funding Received



Note: Figures exclude Federal and Provincial COVID-19 funding

iii) Proportion of Non-Residential Tax Revenue

Over the past five years, the proportion of tax revenue from the non-residential sector has steadily declined from 36.1 per cent in 2019 to 33.6 per cent in 2023. This has extended a long-term shift in the proportion of the property taxes away from non-residential sectors and on to residents, primarily due to the changing nature of employment as shown in Chart 5 below.

Essentially, the rise of online commerce reduces the demand for commercial space. As a result, the greater share of the tax burden falls on Peel residents, many of whom are themselves facing heightened risks, due to low incomes, food insecurity and housing unaffordability.

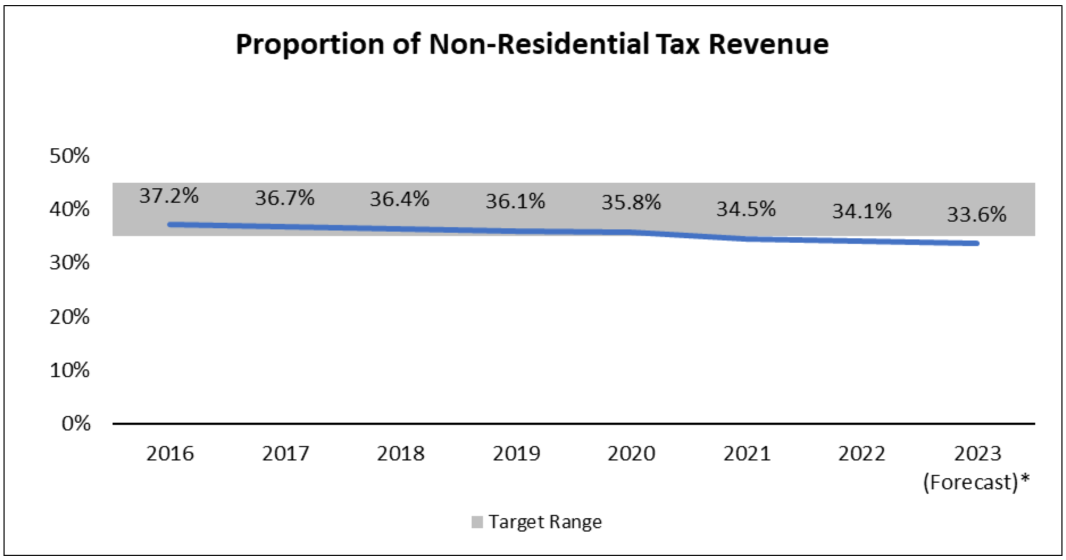
The degree to which COVID-19 enhanced this shift cannot be precisely known. It will largely depend on the permanency of work-from-home policies, instituted during the pandemic, augmented by the pre-existing decline in commercial retail and office space, described above.

In 2019, the Region of Peel responded to the earlier trend by commissioning the Mowat Centre to complete a research paper "Rethinking Municipal Finance for the New Economy". The paper reviewed the implications of the changing nature of employment on municipal fiscal sustainability and the resulting shift in the property tax burden to residents.

The report was subsequently shared with Council and Peel's municipal partner organizations, as part of the Peel's advocacy efforts to address the impacts of the changing nature of work on municipal fiscal sustainability. One of the report's main recommendations was for new revenue sources and collection tools to be made available to municipalities.

More recently, both the City of Mississauga and the City of Toronto have been researching new revenue tools in the face of current and ongoing economic challenges. It remains to be seen if their efforts will create any renewed interest on the part of the Province. For its own part, Peel has maintained municipal fiscal sustainability and its calls for new revenue sources and collection tools as a long-standing focus of its advocacy efforts.

Chart 5: Historical Trend of the Non-Residential Tax Revenue Share

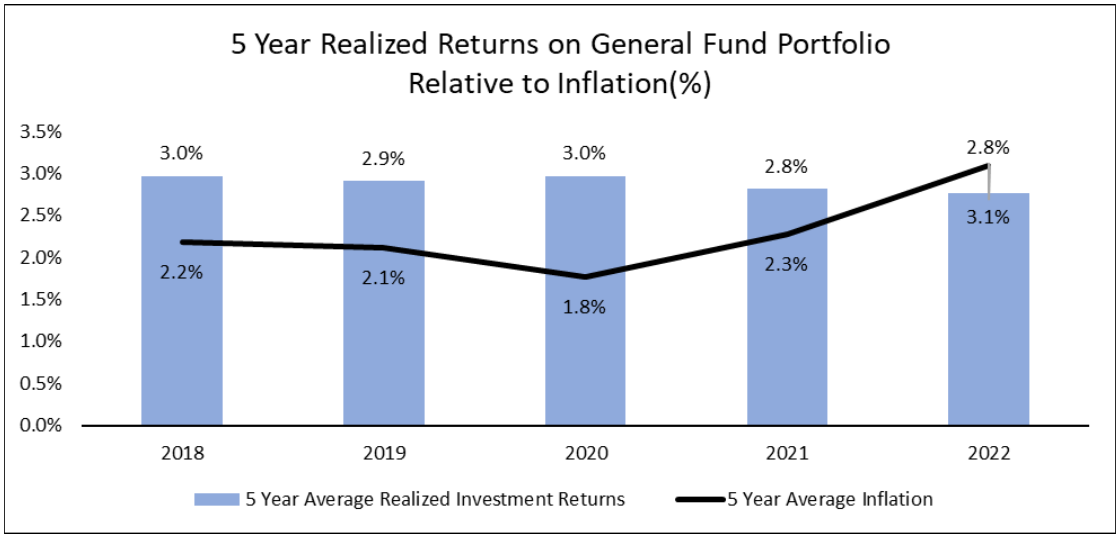


iv) Investment Returns

During 2022, investments generated realized earnings of 2.3 per cent, with a five-year average return of 2.8 per cent (as shown in chart 6 below). Inflation accelerated during 2021 and 2022 (4.7 per cent and 6.0 per cent, respectively year-over-year as at December) at levels not seen since the 1970s, with five-year average inflation having risen to 3.1 per cent. As a result, it has become more difficult for fixed income returns to keep pace with inflation. Central banks have been working to combat inflation, through rising interest rates during 2022, at one of the fastest paces on record. Taking into account the rise in interest rates, the portfolio has been able to purchase new investments at attractive rates, and it is expected that if inflation moves closer to Central Bank target levels (i.e. 2 percent), the General Fund portfolio will be positioned well over the coming years.

Targeting long-term earnings above inflation helps preserve the purchasing power of the Region's funds and meet future funding requirements. Should inflation remain elevated at current levels, it will be difficult in the short-term to achieve earnings above inflation. Since 2020, the Region has held approximately 5.0 per cent of the portfolio in an equity fund to diversify portfolio holdings; historically, equities have provided higher long-term returns than fixed income - in late 2022 the equity position was reduced to approximately 2.5 per cent to reduce the overall risk in the portfolio.

Chart 6: General Fund Realized Earnings

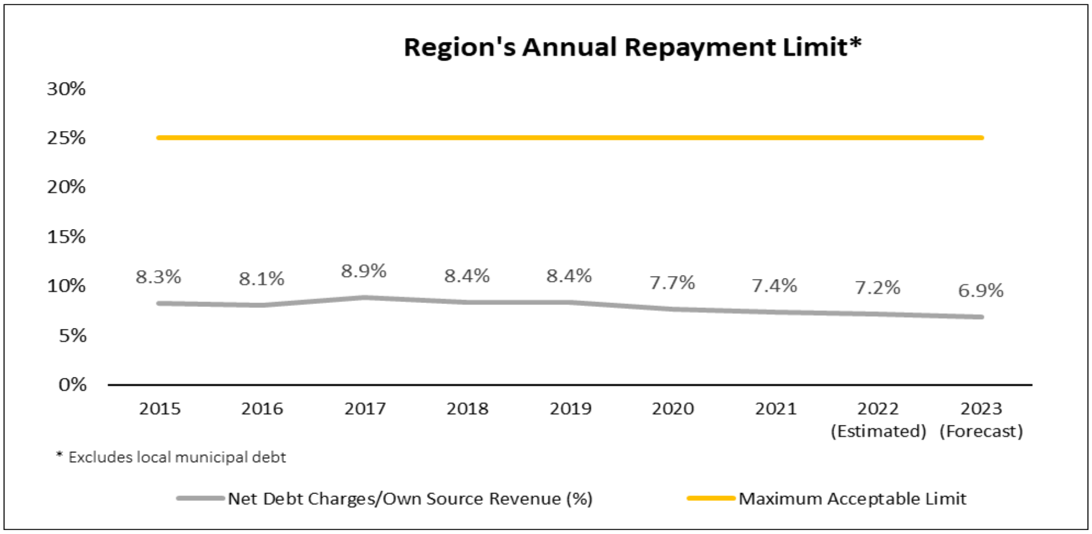


c) Financial Flexibility:

i) Debt Capacity

The Annual Repayment Limit has been declining since 2017 and remains well below the Province's maximum acceptable limit as shown in chart 7 below. The decrease versus 2021 is a result of increasing own source revenues, partially offset by debt service costs related to approximately $20 million net debt increase in 2021. During 2022 there was no Region related debt activity (i.e. issuance or maturities). The forecasted decrease in 2023 is based on stable principal and interest payments but increasing own source revenue.

Chart 7: The Region's Historical Debt Repayment



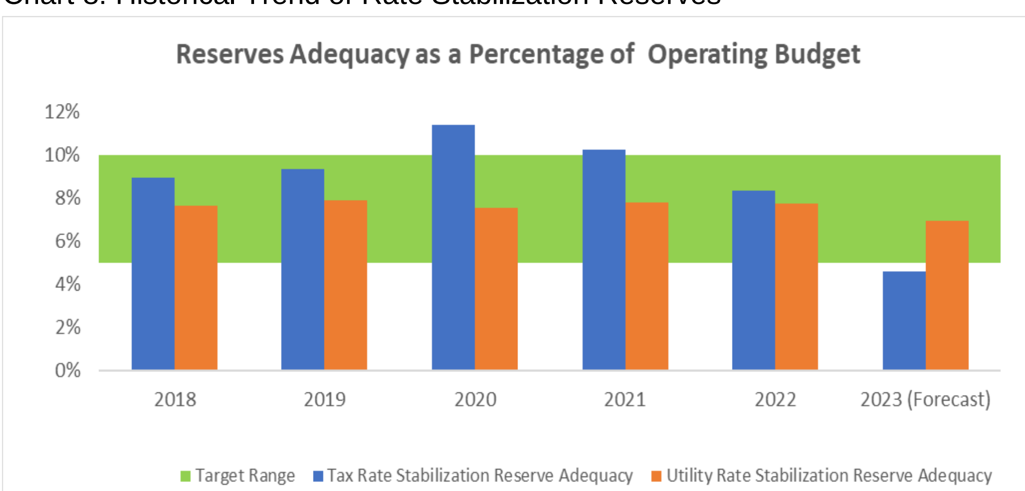
ii) Adequacy of Reserves

The Reserve Management Policy requires that the balance of the Tax Supported Rate Stabilization Reserve and Utility Rate Stabilization Reserve be maintained within a range of a minimum of five per cent and a maximum of ten per cent of the total budget for Tax supported programs and Utility Rate supported programs respectively.

The balance of the Tax Rate Stabilization Reserve as of December 31, 2022, was $157.8, or 8.3 per cent of the 2023 Tax Supported Operating Budget, which is in compliance with the prescribed requirement. As the performance indicator is done using data as of December 31, 2022, this excludes any reserve draws that were approved as part of the 2023 Budget and any draws that have been made via 2023 Council reports in 2023.

The balance of the Utility Rate Supported Stabilization Reserve as of December 31, 2022, was $50.8 million, or 7.7 per cent of the 2023 Utility Rate Supported Operating Budget, which is in compliance with the prescribed requirement.

Chart 8: Historical Trend of Rate Stabilization Reserves



iii) Liquidity

The Region continues to maintain exceptional levels of liquidity. The liquidity indicator measures if the Region has enough liquidity to pay off its debt obligations. A higher ratio implies that the Region is better equipped to meet its liabilities.

ADVOCACY FOR MUNICIPAL FISCAL SUSTAINABILITY

In addition to Peel's efforts through the Long-Term Financial Planning Strategy, the Region continues to look for opportunities to educate provincial and federal officials, as well as stakeholders, on the need for municipal fiscal sustainability. The Region provides advocacy, and recommends that the Province carry out the following:

Within the next two years (short term):

- Create a municipal compensation fund to make Peel Region and the local municipalities financially whole and to mitigate the significant impacts of Bill 23 on municipal growth funding revenues and expenditures
- Ensure funding is commensurate with expected high inflation to maintain real spending levels;
- Address historic underfunding for provincially mandated services in Peel; and
- Partner with the federal government to ensure that Peel receives sustainable infrastructure investments;

Within the next three to five years (medium term):

- Continue to advocate for a review of federal-provincial-municipal funding responsibilities, with a focus on removing income redistribution programs such as Housing, Ontario Works and Child Care, from the Property Tax;

Beyond the next five years (long term):

- Engage with municipalities in discussion on the need for updated municipal revenue sources and collection tools to address the changing needs of local communities.

Such messaging is consistently conveyed by the Region to federal and provincial governmental ministers, during the annual Association of Municipalities Ontario and Federation of Canadian Municipalities conferences and in the Region's pre-budget submissions to both governments.

BILL 112 RISKS AND IMPLICATIONS

On June 8, 2023, the *Hazel McCallion Act (Peel Dissolution Act, 2023)* (Bill112), received royal assent. At the time writing this report, the Ministry of Municipal Affairs and Housing was developing the Terms of Reference and in the process of appointing the Transition Board.

Under Bill 112, recognizing that no details have been provided yet, the Transition Board, once in place, will ensure that transactions and/or decisions after May 18, 2023, are done in the interest of the public, are done in a manner that does not unreasonably impact another municipality and having regard to municipal restructuring.

2023 Update of the Region of Peel's Financial Condition

On June 8, 2023, Regional Council approved principles to maintain Regional services through the transition period and prepare for the 2024 Budget in the Council report from the Chief Administrative Officer titled, "Bill 112 – Managing Through the Transition". For the purposes of the Annual Financial Condition Scorecard, staff assessment of the financial performance indicators was done under the assumption that services and service levels would be maintained including maintaining the state of good repair of assets. However, additional details of how the legislation will be implemented are still unknown and there is still a large degree of uncertainty related to the future structure of Peel's services. The overall future structure of Peel's services after dissolution could have a material impact on the financial sustainability of the services.

CONCLUSION

The Long-Term Financial Planning Strategy has helped Peel remain financially healthy since its adoption in 2013 and will continue to help guide Peel through challenging economic times. The updated Strategy and 2023 Financial Scorecard include a number of actions that will help Peel remain fiscally sustainable over the long term and maintain its strong credit ratings.

APPENDICES

Appendix I - 2023 Financial Scorecard

Patricia Caza

Patricia Caza, Chief Financial Officer and Commissioner of Corporate Services

Authored By: Norman Lum, Director, Business and Financial Planning and Deputy Treasurer