

REPORT

Council

Meeting Date: August 9, 2022

FROM: Finance Department

DATE: July 26, 2022

SUBJECT: 2023 Budget Forecast and Direction

LOCATION:

WARD: Town-wide

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RECOMMENDATION:

THAT the staff report dated July 26, 2022, entitled *2023 Budget Forecast and Direction* from the Finance department, be received.

KEY FACTS:

The following are key points for consideration with respect to this report:

- Council set a guideline for an overall tax levy increase for 2023 in line with inflation.
- The inflation forecasts in the Bank of Canada (BOC) July Monetary Policy Report have been revised up by almost 2 percentage points to 7.2% in 2022, by 1.8 percentage points to 4.6% in 2023, and by 0.2 percentage points to 2.3% in 2024.
- Unlike the past decade of budgets where inflation has remained quite stable, the current economic and inflation environment makes it difficult to determine what the tax increase should be.
- Rising inflation impacts both residents and the town so it is important that budget increases balance the impact on residents against the impact on the town's financial stability and services offered.
- In line with Council's direction, the overall increase would be 4.60% based on BOC's 2023 inflation forecast.
- However, should the 2023 Budget Committee decide to keep the overall increase at less than forecasted inflation, staff will prepare a number of reduction options for the 2023 Budget Committee to consider.
- There are significant pressures on the budget which will need to be considered and addressed over the coming months, including:
 - The impact of high inflation as a result of both global and domestic pressures
 - Recruitment, staff retention and wage pressures

- Longer term COVID impacts on services such as transit
- Economic uncertainty
- Uncertainty related to provincial funding and planning requirements
- Resourcing requirements to support programs and services

BACKGROUND:

The 2023 budget process is now underway. As part of the 2020 budget recommendations, Council approved the following guideline for the preparation of the 2021 to 2023 budget:

That, in addition to Council's existing direction to keep overall property taxes in line with inflation for 2020, that the 2021, 2022 and 2023 budgets be prepared keeping overall property tax increases in line with inflation.

This report provides a preliminary update on the tax levy increase based on the guideline and significant budget pressures that will need to be considered and addressed over the coming months.

COMMENT/OPTIONS:

Council gave staff direction to prepare the budget with an overall increase in line with inflation. Based on current conditions, the Bank of Canada forecast for average annual inflation for 2023 is 4.60%. To achieve an overall increase of 4.60%, the town's portion of the tax levy increase, after projected assessment growth of 1.50%, would be calculated as 8.34%. This assumes an increase of 3.00% for the Region, as based on their recent budget direction report, and no increase for Education; both of these assumptions are outside of the town's control and could be subject to change.

Recognizing that an 8.34% town portion increase is higher than anticipated along with the current economic uncertainty and the impact inflation and rising interest rates may have on residents and businesses, staff will prepare reduction options for the 2023 Budget Committee to consider should they wish to achieve an overall increase below forecasted inflation, balancing the corresponding impact on town services and the financial sustainability of the town.

Budget Pressures

There are significant pressures facing the town as the 2023 budget and two year forecast and the 2023 capital budget and 9 year forecast is prepared. Information regarding the pressures is outlined in greater detail below.

Inflationary Pressures

As indicated earlier in the report, the overall increase would be set at 4.60% based on the Bank of Canada inflation forecast. In June 2022, the annual headline

inflation rate hit 8.1% year over year, marking the fastest pace since 1983, and it is expected that inflation will hover around 8% over the next few months before it begins to decline. Global pressures as a result of the pandemic resulted in supply shortages and commodity price volatility. Lockdowns in China and the war in Ukraine have caused global supply challenges to persist in 2022. Inflation has continued to rise and even broaden in Canada as a result of excess demand, impacting all measures of core inflation. BOC survey responses indicate that consumers and business expectations for inflation have also increased, which raises the risk that inflation will become entrenched.

Policymakers are concerned with current inflation and inflation expectations, and are acting forcefully in an attempt to cool inflation and avoid a potential recession. The Bank of Canada has been increasing interest rates, including a 1.00% hike on July 13th, the largest increase since 1998. In the Bank of Canada's July Monetary Policy Report, inflation forecasts have been revised up by almost 2 percentage points to 7.2% in 2022, by 1.8 percentage points to 4.6% in 2023, and by 0.2 percentage points to 2.3% in 2024.

The current inflation level is putting considerable pressure on the 2022 budget which was prepared based on a much lower inflation assumption. The pressure experienced this year has put the town in a difficult starting position for the 2023 budget as some of the major expenditures such as fuel, materials, supplies and contracted services have increased at a much larger rate than anticipated. As a result, the 2023 budget for these items will need to account for cost increases this year as well as expected increases for next year. For example, staff are currently assuming a 50% increase to fuel rates, resulting in a \$2.5 million tax levy impact, as this represents the average cost over 2021 and 2022; a further increase of 10% would have an additional \$500,000 or 0.23% impact on the town portion of the tax levy.

Furthermore, based on the current economic and supply chain market, construction costs have increased dramatically over the last year. The current market impact can range anywhere from 15% to 50% or more on some types of projects. According to Statistics Canada, non-residential construction building costs in the Toronto area rose 17.3% year over year in the first quarter of 2022, which was the largest increase since the third quarter of 2008. Select materials incurring significant cost increases since 2021 include union labour up 5%, hardware up 50%, wood up 25%, steel up 30% and drywall up 25%. The construction market continues to face the same cost pressures that were heightened by COVID including a shortage of skilled labour, an abundance of projects in both the public and private sectors, supply chain timing and availability issues, and a continued upward pressure on the supply cost materials.

In preparing the 2023-2032 capital forecast, active capital projects approved in previous years will also be reviewed and reprioritized as necessary given the current inflationary environment and supply chain concerns.

Labour Market and Workforce

Despite having a reputation of being an employer of choice, the town is facing increased challenges in attracting talent as a result of the current job market where demand for skilled workers is much greater than the supply. The town's traditional reliance on contract positions to address capital project and supplemental staffing needs is being significantly disrupted given readily available permanent positions elsewhere. Part-time positions are also proving difficult to fill. Competition in the labour market has increased and while the town is taking steps to mitigate these challenges, the ability to recruit qualified candidates remains a significant risk for the town for at least the near term.

Compounding the recruitment challenges, the town is experiencing higher-than-normal turnover for full-time positions. Historically, the town's typical voluntary turnover rate averaged 3-4% each year. This has increased to an average of 5-6% during the pandemic. While the national average for turnover is much higher at 16%, this is greater than traditionally experienced at the town. The combined challenges of higher than normal turnover and the competitive recruitment market is resulting in hiring delays and subsequent impacts to service levels and capital project implementation delays. From January to the beginning of July 2022, the town has actively recruited for approximately 150 full time and contract job postings successfully hiring 122 staff with approximately 17% representing duplicate recruitments. These numbers represent a significant increase in recruitment volume compared with our typical recruitment activity pre-pandemic attributed to the increase in turnover, subsequent internal movement and unprecedented duplicate postings.

The current labour market, along with inflation rates, is contributing to budget uncertainty. Media has highlighted 2022 as the year of the strike with the potential for significant labour unrest across multiple sectors. More than 80% of the town's full-time positions are unionized and the town has already experienced strike action earlier this year with Unifor. This risk continues with contracts for both CUPE unions expiring in early 2023. As always, the administration remains hopeful that strike action will be avoided but increases to wages to address inflation and other monetary and benefit improvements will place pressure on an already tight budget. The OPFFA's agreement also expires at the end of 2022, and while the association does not have the right to strike, the ability to freely negotiate an agreement and avoid interest arbitration would be ideal.

With employee salaries and benefits representing 48% of the town's gross operating expenditures in the 2022 budget, every 1% increase to wages represents 0.8%

increase to the town portion of the tax levy. Compensation policies and rates are currently being assessed to confirm competitiveness with comparator municipalities and that rates align with the compensation policy. Budget projections include known and estimated contractual increases and these projections will be updated over the next several months as more information is gathered.

COVID-19 Impacts

The 2022 budget included \$5.69 million in COVID-19 impacts along with \$5.69 million in Government support, yet to be announced, to offset these COVID-19 impacts. The March 31, 2022 Financial Results report projected a further \$4.82 million in impacts by year-end. While the budgeted impacts have been removed for 2023 and staff are hopeful that there will not be further lockdowns, some areas such as transit will take longer to return to pre-COVID levels. It is difficult to predict when ridership will return to pre-COVID levels; as a result, staff are currently projecting a \$3 million impact for 2023. Ridership levels continue to be monitored and the assumptions on recovery will be updated as the budget is finalized.

Uncertainties at the Provincial Level

It is not yet clear what the new provincial government's priorities are and how they may impact municipalities. For the town, this is important when it comes to any support related to COVID-19 recoveries and for any changes to planning regulations.

Bill 109 (More Homes for Everyone Act) received Royal Assent on April 14, 2022. While the legislation maintained the timeframe for the review of most development applications, it introduced a schedule of refunds that must be provided to the applicant should the approval timeframes not be met by the municipality. This may result in a shortfall of planning revenues which will otherwise need to be funded by the town's tax levy.

The timeframes to review development applications was already difficult and imposing a refund schedule along with these timeframes could adversely affect overall revenues. Staff are working to refine development application review processes to try to accommodate the timeframes to the greatest extent possible; however, the review process involves public agencies and utilities outside of the town's jurisdiction, but who are important contributors to ensure sound community planning. Furthermore, the town's responsibility to meet timeframes can be affected by developers who may choose to 'wait out the clock', with the intent of realising a refund by not substantially participating in the review process. Staff will be looking at additional approaches to mitigate refunds.

Staff are in the midst of reviewing past years' performance and will attempt to identify the risks to revenue that may result and factor those into the 2023 budget.

Economic Uncertainty

Staff will continue to monitor economic conditions as a downturn in the economy could have an impact on user fee and permit revenues. The previous significant downturn in the economy in 2008-2009 resulted in a negative impact on development activity and revenue. The town's Tax Stabilization reserve and Building Enterprise reserve are healthy and can be used to offset potential short-term revenue losses.

A 4.60% inflationary increase on rates and fees will be assumed in the preliminary budget forecast to be presented to the Budget Committee in 2023, representing additional revenue of \$2.5 million. The rates and fees charged for services can significantly impact demand. While it is difficult to quantify any financial impact at this time, as users weigh affordability in these uncertain economic conditions, there is a risk that some town programs and services may be impacted resulting in less activity and lost revenue. However, a fee increase that does not cover normal inflationary impacts to program costs will add further burden to the tax levy. If the fees were to be kept at 2022 rates, there would be a \$2.5 million or 1.13% impact on the town portion of the tax levy.

Programs and Services

Beyond the financial pressures noted above, the town continues to respond to important social and economic issues. Addressing diversity and inclusion, truth and reconciliation and climate action are a few examples of critically important work that requires sufficient resourcing to support meaningful change at the town. In addition, ever-increasing staff workloads resulting from growth, capital projects and/or legislative requirements, has resulted in pent-up staffing needs in both corporate services and service delivery areas.

As well, to ensure continued service delivery during the pandemic lockdowns, the implementation of property-related online services was significantly accelerated. While the public can now access many services through entirely electronic channels, the speed of implementation resulted in increased back-end workloads and the continuation of inefficient processes. As a result, the back-end work to gain the needed efficiencies is still underway and remains a priority.

Next Steps

Budget Committee meetings are expected to be held in January 2023 with final Council approval expected to be in late February or early March 2023. Key dates for the 2023 budget process will be communicated once finalized.

Over the coming months, staff will be working on their budget submissions with the focus on refining their operating and capital budget and forecast using the latest information available to make reasonable assumptions with due consideration given to current and anticipated economic conditions.

In attempting to balance the significant uncertainties faced in this budget process with the impact that a property tax increase would have on residents, staff will also prepare service reduction options for the Budget Committee to consider to achieve a town increase of 4.6% plus 1% for the capital levy after projected assessment growth of 1.50%. This increase, combined with an assumed increase of 3.00% for the Region and no increase for Education, would result in an overall increase of 3.46%. This will allow the committee to consider the overall tax increase along with program and service needs and cost saving opportunities to best balance the needs and concerns of residents.

CONSIDERATIONS:

(A) PUBLIC

All budget meetings are open to the public and will be streamed online.

(B) FINANCIAL

The approved budget will result in the tax levy increase for 2023.

(C) IMPACT ON OTHER DEPARTMENTS & USERS

All departments participate in the budget process.

(D) CORPORATE STRATEGIC GOALS

This report addresses the corporate strategic goal(s) to:

- Be an Accountable Government.
- Be fiscally sustainable

(E) CLIMATE CHANGE/ACTION

Climate change/action is a key priority of Council. The proposed budget will incorporate climate change initiatives in alignment with this strategic priority.

Prepared by:

Dalibor Stancovici

Manager of Financial Planning and Policy

Recommended by:

Jonathan van der Heiden

Deputy Treasurer and Director of Finance

Julie Clarke

Director of Strategy, Policy, and Communications

Submitted by:

Nancy Sully

Commissioner of Corporate Services and Treasurer