May 18, 2022

Financial Indicators

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Department: Financial Services

Report Summary & Recommendation

The City monitors financial indicators in three main areas based on the Public Sector Accounting Board's Statement of Recommended Practice:

Flexibility – Does The City have access to various funding sources as needed?

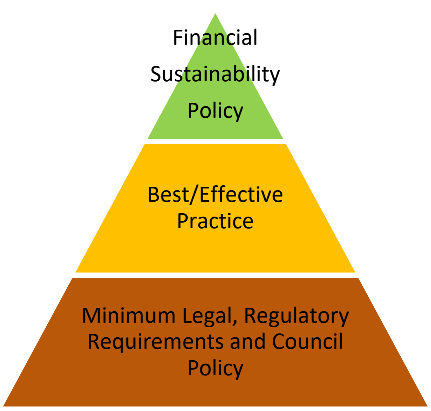
- Debt outstanding and debt limit
- Financial assets to liabilities
- Debt charges to revenues

Sustainability – Can The City maintain a strong financial position?

- Total operating expenses/total assessments
- Capital expenditure to annual depreciation
- Net book value of TCA to cost

Vulnerability - Is The City's financial status susceptible to changes outside of its control?

- Government transfers to total revenue
- Operating surplus ratio
- Reserve coverage ratio



Some of the financial indicators above have minimum legal or regulatory requirements (bottom of the triangle) that must be met, such as: debt limit, debt charges limit, and operating surplus. Other financial indicators can be benchmarked with best practices (middle of the triangle) that vary from city to city. All the indicators taken as a whole link to financial sustainability policy (top of the triangle).

The above financial indicators have been calculated in the body of this report using the 2021 annual financial statements.

No one indicator's performance should be used to assess the overall financial performance of The City and should be considered as a whole with the other indicators in all three areas as well as the financial statements themselves.

Proposed Resolution

Receive for Information

Background

This report comes to the Audit Committee on an annual basis after the approval of the financial statements, and is part of the exception reporting process.

Prior Council/Committee Direction:

At the October 14, 2020 meeting of the Audit Committee, the following motion was introduced and passed:

> *Resolved that the Audit Committee, having considered the report dated October 14, 2020 re: Exception Reporting Discussion, hereby agrees to the following:*
>
> 1. *Allow for four months of operating variance reporting ending December 31, 2021, where the previous three can vary depending on budget scheduling.*
> 2. *Discontinue the quarterly procurement card exception report.*
> 3. *Bring purchasing and accounts receivable exception reports on an annual basis.*
> 4. ***Include financial indicators reporting in future work plans.***

Strategic Alignment:

Knowing where The City stands financially gives the Audit Committee confidence that The City is adhering to the core principles of its Financial Leadership Framework: Transparency, Stewardship, Accountability, Balanced and Forward Thinking, and Flexibility. These indicators are key in providing a full picture of The City's financial performance, while making financial information accessible and understandable to Council as well as the public.

Analysis

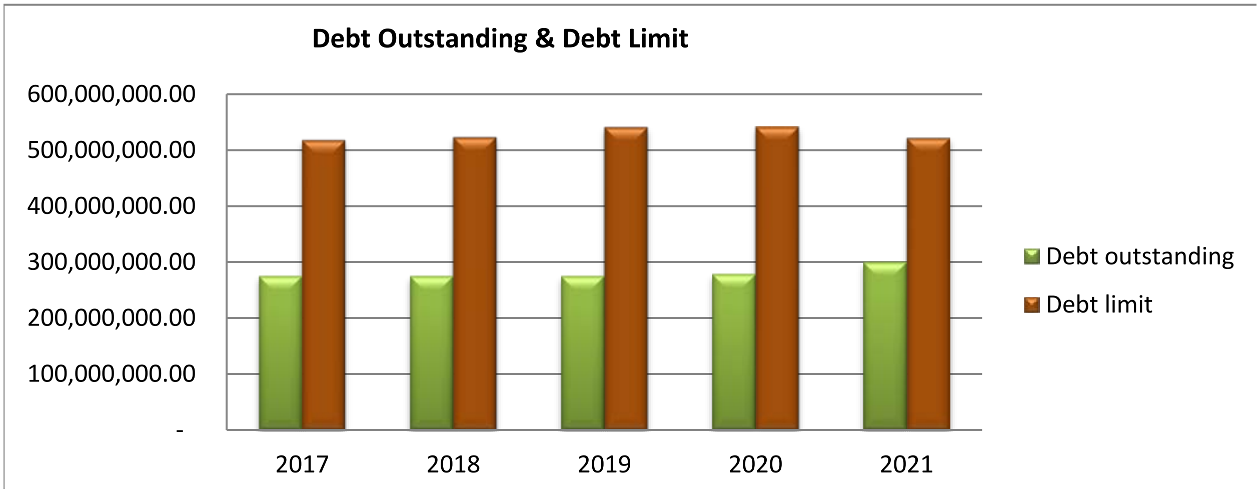
Flexibility Ratios:

Debt Outstanding and Debt Limit

What is the debt limit?

The City is subject to a debt limit of 1.5 x annual revenue (total revenue less capital grants and contributed assets). If The City were to approach 75% of its debt limit, the Provincial Government would require additional reporting to advance funds, and provincial approval is required to exceed the limit. Council Policy dictates that the debt limit does not exceed 75%.

What are the results for The City?



What do the results mean?

The City's provincially-imposed debt limit percentage increased to 58% and 77% of the Council policy limit.

In 2021, The City's long term debt balance increased by $22.0M as total revenues for purposes of calculating the debt limit decreased by $13.5M. Capital asset additions did increase over last year, but it was mainly due to stimulus grants with no more borrowing than in prior years. This year, borrowing related to operating made up the majority of the long term debt increase. The revenue decrease was largely due to continued user fee reductions caused by the pandemic as well as not receiving the $11M operating COVID-19 grant like in 2020.

External Benchmark:
MGA Section 276(2) Alberta Regulation 255/2000 – Debt limit set at 1.5 x annual revenue
Internal Benchmark:
Council Policy GP-F-2.2 sets a limit of 75% of the provincial debt limit.

Financial Assets to Liabilities

What is Financial Assets to Liabilities?

$$\frac{\text{Total Financial Assets}}{\text{Total Liabilities}}$$

This ratio is used in many sectors and indicates the ability to manage liabilities on an ongoing basis using only financial assets, like cash, receivables, and investments.
An ideal target is one or greater, which indicates that financial assets are equal to or greater than total liabilities.

What are the results for The City?

		2017		2018		2019		2020		2021
Financial Assets to Liabilities		0.78		0.80		0.79		0.81		0.79
Current Assets to Liabilities		0.84		0.89		0.76		0.86		0.84

What do the results mean?

This is a flexibility (and sustainability) measure that shows how much of The City's liabilities are covered by its financial assets. This measure can fluctuate as liabilities are paid off, loans received, or cash invested at a certain point in time. In 2021, this measure has decreased by only 0.02% from 2020 due to large increases in financial assets mostly offsetting the large increases in liabilities.

When taken without long term financial assets and liabilities, The City reports the same 0.02% decrease over last year. Much of the change has to do with COVID-19 grants reported in both years. Had there been no COVID-19 grants, the financial assets to liabilities ratio and the current assets to liabilities ratio would be 0.75 and 0.76 respectively, which is a 0.03% decrease over prior year. The COVID-19 capital grants will continue into the next two years, and therefore, Administration expects this ratio to fluctuate further during that time.

Risks: A decreasing ratio over time indicates that additional debt will need to be managed carefully.

External Benchmark Source:
Municipal Affairs – Fiscal Report Card >=1.00

Internal Benchmark Source:
TBD

Debt Charges to Revenue

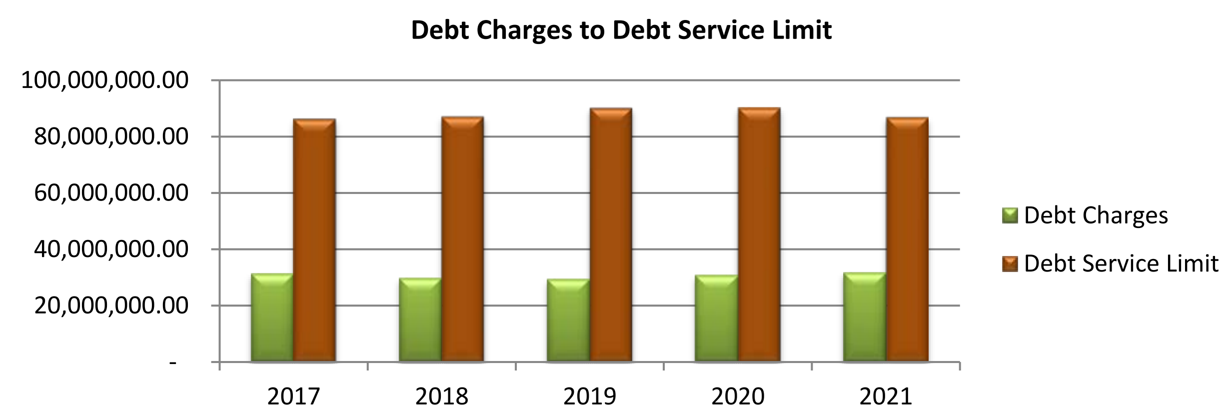
What is the indicator?

$$\frac{\text{Principal and Interest on Debt}}{\text{Annual Revenue}}$$

This ratio indicates the current funds required to repay past debt borrowings and computes it as a percentage of annual revenue (total revenue less capital grants and contributed assets). Provincial regulation describes an upper limit for debt servicing of 25% of such revenue.

What are the results for the City?

	2017	2018	2019	2020	2021
Debt Charges to Revenues	9.07%	8.53%	8.15%	8.56%	9.12%



What do the results mean?

In 2021 9.12% of revenues are required to repay existing debt. This measure has gone up substantially over last year in order to fund the loan to the Westerner Exposition Association (WEA). This measure has been on an upward trend since 2019. This is due to new debenture debt servicing increasing at a faster rate than annual revenue.

The City has used up to 36% of the provincially imposed debt service limit and 61% of its own internally imposed service limit.

Risks: The amounts of revenues committed to pay debt needs to be closely managed, as significant increases can negatively affect The City's ability to maintain a flexible approach in the face of economic changes.

External Benchmark:

MGA Section 276(2) Alberta Regulation 255/2000 – debt charge limit set at 25% annual revenue
Municipal Affairs – Fiscal Report Card – debt charges to revenue must not exceed 20%

Internal Benchmark:

R Council Policy GP-F-2.2 debt charge limit to not exceed 15% of annual revenue.

Sustainability Ratios:

Total Expenses to Assessments

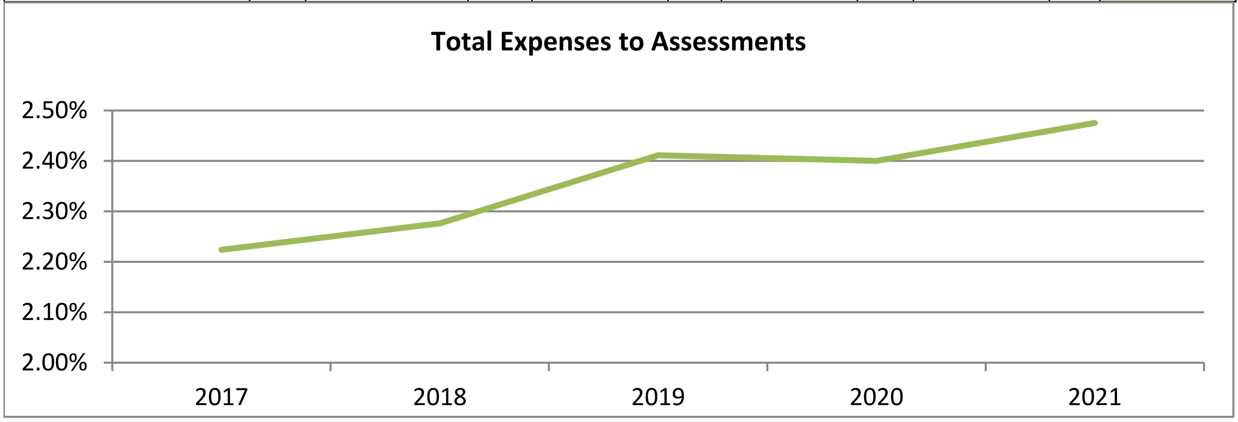
What is the indicator?

$$\frac{\text{Total Operating Expenses}}{\text{Total Property Assessments}}$$

This indicator compares total operating expenses to total property assessments in The City. Total assessments are used as a proxy for economic activity. Total expenses for the municipal organization should generally not rise faster than economic activity in the community in order to preserve comparative levels of service.

What are the results for the City?

		2017		2018		2019		2020		2021
Total Expenses to Assessments		2.22%		2.28%		2.41%		2.40%		2.48%



What do the results mean?

Since 2015, this indicator has been on an upward trend, which means that expenses are increasing at a faster rate than economic growth. This is due to expenses increasing steadily do over time while assessments have decreased as a result of economic slowdown. In 2021, the ratio went up by 0.08%. This is due to a 1.47% increase in expenses and a 1.6% decrease in property assessments. As the economic climate improves, this indicator will start decreasing again. To keep this indicator from increasing in the meantime, keeping downward pressure on expenses is recommended.

External Benchmark:
N/A

Internal Benchmark:
Recommended not to exceed 5.0%.

THE CITY OF Red Deer

Capital Expenditure Ratio

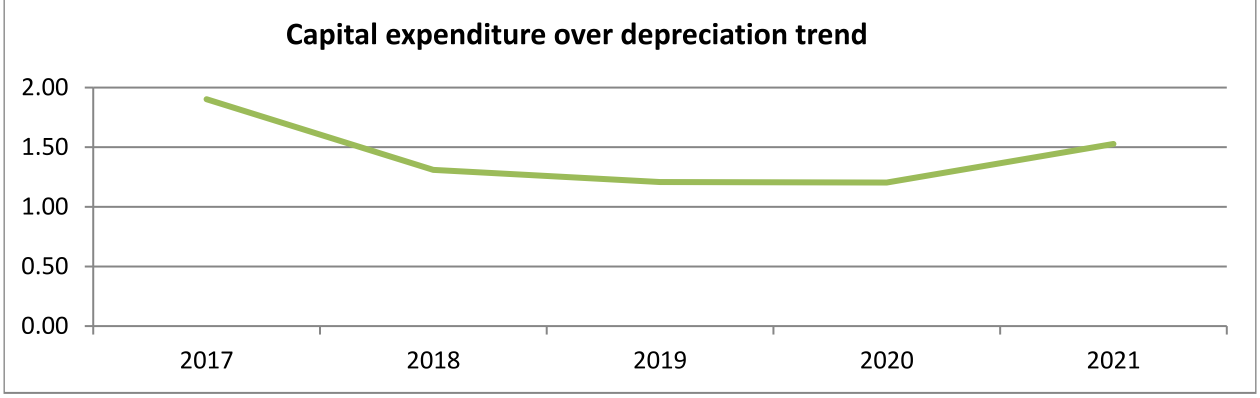
What is the indicator?

$$\frac{\text{Annual Capital Expenditures}}{\text{Annual Depreciation}}$$

This ratio indicates whether capital investments are being made at a rate of at least the levels of depreciation each year. A value of less than one indicates that investments are less than the annual reduction in value of existing assets, and a prolonged reduction could ultimately place The City's assets at risk due to declining condition. (This indicator does not include contributed assets.)

What are the results for the City?

		2017		2018		2019		2020		2021
Capital expenditure ratio		1.90		1.31		1.21		1.20		1.53



What do the results mean?

Historically, capital expenditures have outpaced depreciation by a factor of at least 2 times until 2017. The downward trend can be attributed to reduced capital expenditures over the years while deprecation of existing assets remains relatively constant. In 2021, this measure has shot up to 1.53 due to capital stimulus grants allowing for higher capital expenditures to levels nearing 2017.

Risks: This indicator is more useful with a comparison of infrastructure backlog as it does not indicate where capital investments should be spent. Refurbishment of older assets is as important as new investments. Additionally, many of the capital items require continuing commitments from grant programs by other levels of government, which are not assured.

External Benchmark:

New South Wales Treasury Corporation, NSW Australia - > 1.1

Municipal Affairs – Fiscal Report Card – average capital additions > average depreciation over 5 years

Internal Benchmark:

Recommended minimum of 1.0.

Net Book Value of Tangible Capital Assets to Cost

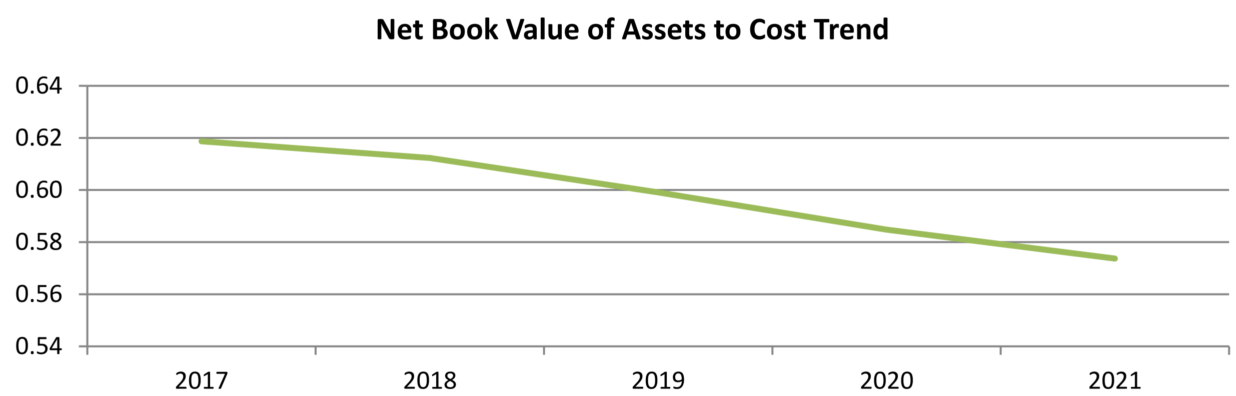
What is the indicator?

$$\frac{\text{Net Book Value of Tangible Capital Assets}}{\text{Cost of Tangible Capital Assets}}$$

This ratio compares the net book value to the original cost. It does not include land or work in progress as they are not depreciated. In an environment of investment in assets, the indicator should stay stable or increase.

What are the results for the City?

		2017		2018		2019		2020		2021
NBV of TCA to Cost		0.62		0.61		0.60		0.58		0.57



What do the results mean?

This ratio indicates whether capital investments are adequate to maintain The City's existing assets. The net book value of assets to cost has been very stable over the years, but has been slowly decreasing over the last 3 years. Even with the increase in capital expenditures in 2021, this measure still decreased. This is due to larger proportion of new additions being in land and work in progress which are not included in this calculation.

Risks to this indicator include:

- As the asset base increases, capital investments will also need to increase to maintain the ratio, which may not be feasible or recommended for a variety of reasons.
- The type of investments is not considered in this ratio, whether refurbishment or new investment.
- This indicator should be linked to asset condition assessments and asset management plans to provide more meaningful insight.

External Benchmark:

Municipal Affairs – Fiscal Report Card – should be >0.40

Internal Benchmark:

Recommended: Minimum 0.50

Vulnerability Ratios:

Government Transfer to Total Revenue

What is the indicator?

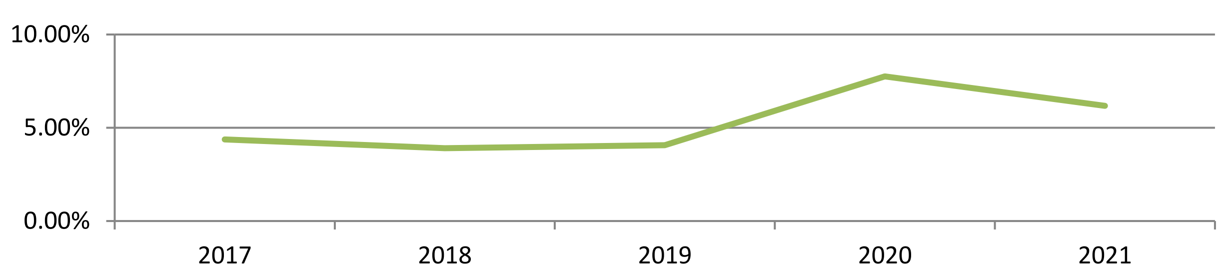
$$\frac{\text{Operating Government Transfers}}{\text{Annual Revenues}}$$

This indicator explains the level of dependence The City experiences due to operating grants received from other levels of government by comparing to annual revenue (total revenue less capital grants and contributed assets). A higher percentage may indicate that The City is in a vulnerable position if these transfers are reduced.

What are the results for the City?

		2017		2018		2019		2020		2021
Government Transfers to Revenue		4.38%		3.90%		4.07%		7.75%		6.17%

Government transfers to revenue trend



What do the results mean?

This indicator has gone up and down over the last 5 years. 2021 saw a decrease from last year of 1.58%. This is due to COVID-19 operating grant received in 2020 that was not received again in 2021. This still leaves quite the increase from other previous years. A $3.5M grant was received for WEA and then paid out of grant expense. If this grant is not included in the numerator, government transfer to revenue would be 5.17%, which provides a clearer picture of The City's dependence on operating grants.

Risks: Reductions in operating grants could negatively affect the ability of The City to provide some services and increases in operating grants makes those services more dependent on them.

External Benchmark:
N/A

Internal Benchmark:
Due to the nature of this funding, there are no recommendations.

Operating Surplus (Deficit) Ratio

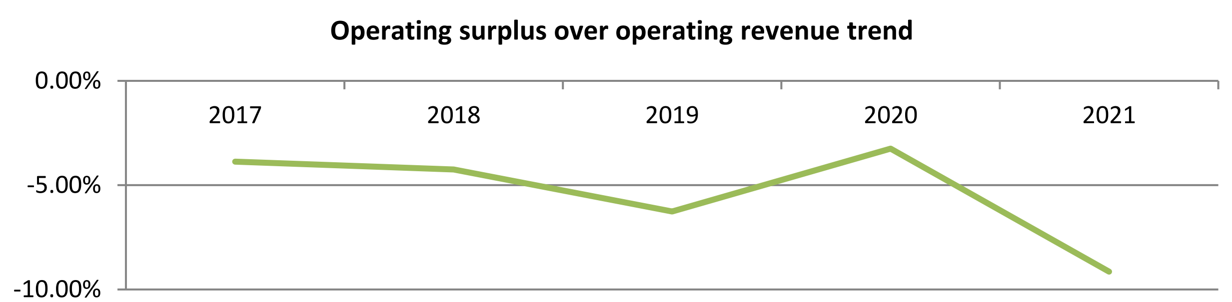
What is the indicator?

<u>Operating Surplus</u>
Total Operating Revenue

An operating surplus is expressed as a percentage of operating revenue and can be either positive or negative. A positive number indicates a surplus of funds. This is considered a Minimum Legal Requirement for The City as municipalities in Alberta are not allowed to incur operating deficits. However, the MGA allows for reserve transfers to offset operating deficits whereas under PSAS they are not reported as such.

What are the results for the City?

		2017		2018		2019		2020		2021
Operating Surplus over Operating Revenue		-3.87%		-4.25%		-6.26%		-3.25%		-9.15%



What does this indicator mean?

The City has suffered a net deficit for six years in a row and anticipates more to come. In 2021, continued challenges with pandemic revenue reductions resulted in a $19.8M increase over last year, the largest operating deficit yet. This decrease was $6.9M less than expected, thanks to operating expenses remaining underbudget. However, it is important to monitor this trend going forward as repeated operating deficits can reduce reserve funds over time, putting The City at risk of not being able to maintain the same service levels in the future.

Risks: This indicator should be interpreted with caution. A positive result may not necessarily indicate superior financial performance.

External Benchmark:

New South Wales Treasury Corporation, NSW Australia
Basic Standard between 1% and 15%, Advanced Standard > 15%

Internal Benchmark:

Recommend a Minimum benchmark only: Must be above zero.

Reserve Coverage Ratio

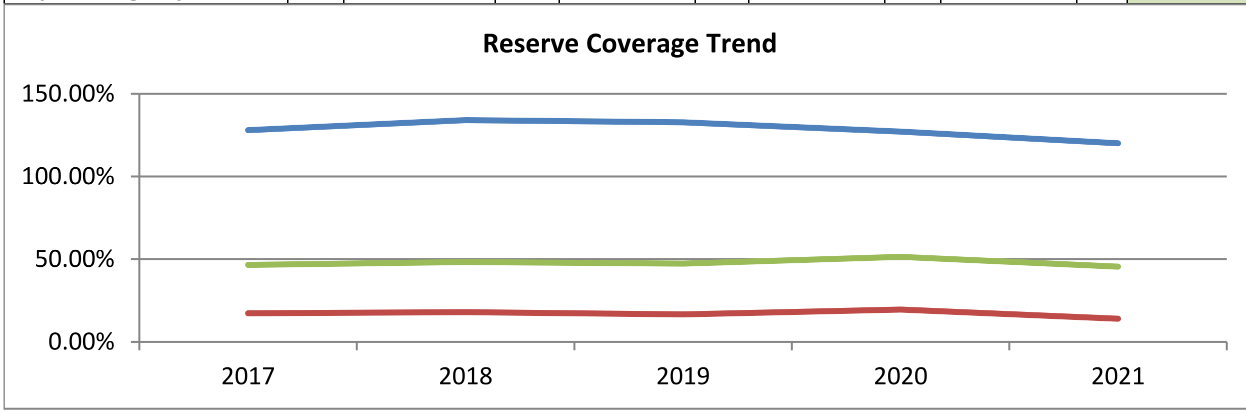
What is the indicator?

$$\frac{\text{Operating Reserves}}{\text{Total Expenses}}$$

This ratio is meant to illustrate the percentage of the total operating expenses that can be covered by reserves (not including capital projects – tax supported, capital asset replacement, and offsite reserves.) A municipality is more vulnerable to financial hardship during economic slowdowns if reserve coverage is too low.

What are the results for the City?

		2017		2018		2019		2020		2021
Reserve to Operating Expenses		46.52%		48.29%		47.33%		51.40%		45.48%



What does this indicator mean?

The City is in a relatively healthy place with its reserves. If all external revenue sources were to dry up as at December 31, 2021, The City could cover almost half of its operating expenses in the following year. This measure has gone down over last year as the effects of the pandemic have reduced operating revenues and reserves needed to be drawn upon. The blue line breaks out the utility and other supported reserve coverage (120%) and the red line is just the tax supported coverage (14%). The green line is all operations taken together (45%).

Risk: A large percentage does not necessarily indicate that vulnerability for The City is low. The use and purpose of each reserve fund must be taken into account (i.e. utility supported vs. tax supported).

External Benchmark:

MFOA (Municipal Finance Officers Association) of Ontario. Low risk if >20%

Internal Benchmark:

New ratio. TBD

Municipal Affairs – Fiscal Report Card

The Alberta Government has launched the Municipal Measurement Index to improve local decision making and allow the public to see how Alberta municipalities spend their tax dollars. Most of the indicators are similar to the indicators in the above analysis, but they also include non-financial or other, less useful, indicators, such as the tax ratios and accumulated surplus.

The following table shows how The City of Red Deer performed on its fiscal report card:

Indicator	**Expected Result**	**City's result**	**Compliant?**
Audit Outcome	Clean audit opinion	Clean audit opinion	Yes
Legislation-Backed Ministry Intervention	None	None	Yes
Tax Base Ratio	No more than 95% residential and farmland tax revenue	61%	Yes
Tax Collection Rate	Collects at least 90% municipal taxes levied in the year	97%	Yes
Population Change	Population has not declined by more than 20% over 10 year period.	Increased over 10 year period	Yes
Current Ratio	>1.00	0.84	No
Accumulated Surplus (in thousands of dollars)	Must be in surplus position (>0)	$2,049,117	Yes
On-Time Financial Reporting	No later than May 2	May 1, 2022	Yes
Debt to Revenue Percentage	Total debt < 120% total revenue	86%	Yes
Debt Service Revenue Percentage	Cost of debt < 20% total revenue	9%	Yes
Infrastructure Investment-Asset Sustainability Ratio	5 year average > 1.00	1.43	Yes
Infrastructure Age-Net Book Value of TCA	>0.40	0.57	Yes