

Long Range Financial Model

Summary Analysis

Town of Morinville

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Presentation Overview

- Project Mandate and Objective
- Model Inputs
- Corporate and Department Assumptions
- LRFM Results
- Implications for Financial Sustainability
- Sensitivity and Scenario Results
- Implications for Financial Policies Framework

- MNP Observations
- MNP Recommendations

Project Mandate and Objective

- Develop a “management” tool that produces a 25-year financial projection and allows for:
  - An Enterprise Wide Model of the Future
  - Scenario and Sensitivity Analysis
  - Easy to Change Inputs
- With a focus on understanding potential:
  - Revenues and Operating Costs
  - Infrastructure and Asset Management
  - Debt Management
  - Reserve Management

Project Objective

- MNP’s goal was to provide the Town with a strategic management tool to understand the impact of alternative financial management strategies and the impact of organizational decisions
- Identify potential areas to improve the Town’s financial health and capital outlook

What is the LRFM?

- It is a dynamic, management planning tool
- It is <u>not</u> a budgeting or reporting system
- It can be valuable to inform the budgeting process
- It should influence strategic and day-to day management decisions

Key Design Considerations

- The LRFM works in a “<u>bottom up</u>” format using the operating and capital inputs from the department level and combining them to provide a view of the Town as an enterprise
- It should not replace what the detailed planning departments currently do; departments provide the inputs for the LRFM
- This LRFM uses 2018 actual numbers as a baseline
- It promotes enterprise level thinking by showing the impact of individual department spending decisions on the entire corporation

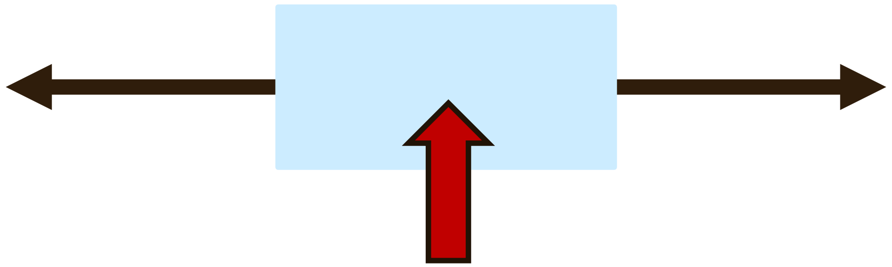
Model Inputs

- Diverse range of consistent model inputs for the full model
- Best quality sources of data

Metric	First Five Years					Historical (Beyond Five Years)			
	1	2	3	4	5	6-10	11-15	16-20	21-25
Demographics									
Statistics Canada 2016 Population	9,848								
Statistics Canada 2016 Household Income	80,578								
Household Growth	2.00%	2.00%	2.00%	2.00%	2.00%	2.50%	2.50%	2.50%	2.50%
Employment Growth	2.50%	2.50%	2.50%	2.00%	2.00%	1.75%	1.75%	1.75%	1.75%
GDP Growth	2.50%	1.40%	1.40%	1.40%	1.40%	1.90%	1.90%	1.90%	1.90%
Rates									
Mill Rate Increase	4.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Residential Tax Base	85.00%	84.00%	83.00%	82.00%	81.00%	80.00%	80.00%	80.00%	80.00%
Non-Res Mill Rate increase (Ratio to Mill)	1.10	1.20	1.30	1.40	1.50	1.00	1.00	1.00	1.00
Non-Residential Tax Base	15.00%	16.00%	17.00%	18.00%	19.00%	20.00%	20.00%	20.00%	20.00%
Consumer Price Index	1.60%	1.75%	1.90%	1.90%	1.90%	1.96%	1.96%	1.96%	1.96%
Municipal Price Index	1.80%	1.80%	2.40%	2.70%	3.00%	3.00%	3.00%	3.00%	3.00%
Construction Price Index	2.60%	2.60%	3.00%	3.20%	3.50%	4.00%	4.00%	4.00%	4.00%
Wages and Benefits Increases	6.00%	5.00%	4.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
BOC 10 Year Auctions	1.90%	2.20%	2.20%	2.25%	2.50%	3.00%	3.00%	3.50%	3.50%
BOC 30 Year Auctions	2.20%	2.50%	2.50%	2.75%	3.00%	3.50%	3.50%	3.80%	3.80%
BOC 10/30 year Auctions	2.00%	2.30%	2.30%	2.40%	2.60%	3.25%	3.25%	3.60%	3.60%
ACFA's Historic Credit Spread	0.85%	0.85%	0.85%	0.85%	0.85%	0.85%	0.85%	0.85%	0.85%
Energy Inflation									
Energy Prices in CPI (2002-2014)	3.38%	3.38%	3.38%	3.38%	3.38%	3.38%	3.38%	3.38%	3.38%
Utilities Inflation	4.21%	4.21%	4.21%	4.21%	4.21%	4.21%	4.21%	4.21%	4.21%
Fuel Inflation	3.37%	3.37%	3.37%	3.37%	3.37%	3.37%	3.37%	3.37%	3.37%

Philosophy to Set Inputs

Reasonable Range



Aimed for the Middle

Realistic and Balanced Approach to Designing the Model Overall

Corporate and Department Assumptions

Note: the model's starting point was the current path for the Corporation; we have not inputted significant strategic choices as part of the base model, and we have not incorporated the 2019 budget.

Individual Department Interviews

- Largely derived through conversations with Directors and Managers of the various departments
- This led to model inputs/changes in the following three areas:
  - Revenue Generation
  - Capital Expenses
  - Operating Expenses including staffing
- The assumptions made by the departments seemed to be based on realistic (but cautious) expectations of future needs (versus a "wish list")
- **Caution**: departments were more likely to be too conservative instead of aggressive on costs; especially in years 6 to 25

Summary of Material Information

What is Included

- Leisure Centre
- Arena Decommissioning
- New RCMP Building
- Policing costs above 15K population

What is Not Included

- Forthcoming Master Plans
- Annexation Considerations
- Library and Museum – Capital

It is important to note that this is not the full picture as a result of what is not included,
As well as any other factors that we cannot anticipate at this time.

LRFM Results

- The Town is projected to have a strong / growing operating surplus for the forecast period.
- The ‘base case’ of the LRFM shows challenges for the Town in remaining below its mandated debt limits which are projected to be exceeded first in 2024-2025 and again starting 2030.
- The model indicates that adjustments to several “levers” will be required for the Town to keep its debt levels to remain below mandated levels.

Operating Fund Net Financial Position

Base Case	Tax Increase*	Residential Tax base	Debt Growth	Cost Reduction	User Fees
	3.0%	80.6%	0.0%	0.0%	2.9%

Year	2019	2020	2021	2022	2023	2025	2030	2035	2040
Revenue	$21,449,432	$22,125,695	$23,146,855	$24,250,443	$25,372,031	$27,711,479	$35,494,411	$44,809,536	$56,930,449
Operating Expenses	$20,771,129	$21,484,973	$22,639,718	$23,424,254	$24,240,501	$26,609,698	$33,202,477	$38,212,280	$44,701,743
Interest Expense	$560,266	$675,549	$871,109	$928,125	$977,400	$1,545,192	$2,328,369	$2,356,774	$2,347,298
Capital Expenditures	$1,211,025	$8,129,752	$22,050,491	$4,896,491	$15,554,980	$19,891,721	$67,825,277	$4,165,726	$186,892
Surplus (Deficit)	$896,038	$640,722	$507,137	$826,189	$1,131,531	$1,101,781	$2,291,934	$6,597,256	$12,228,706
Remaining Debt Capacity	$5,902,473	$5,969,906	$643,533	$1,129,225	$2,833,093	-$3,761,473	-$13,690,940	$1,640,248	$16,527,783

Other Municipalities' Financial Positions

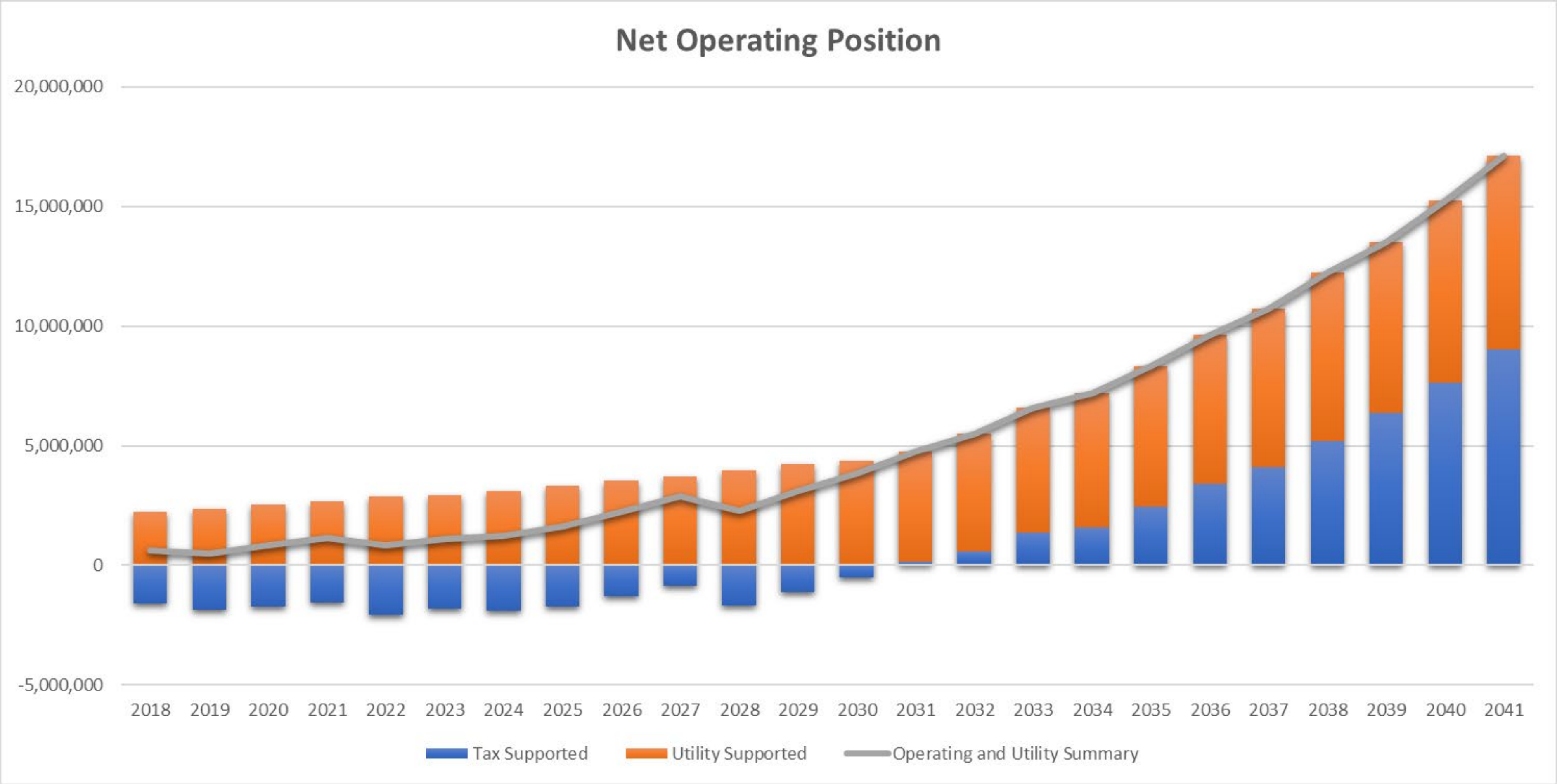
The Town of Morinville is not unique in its financial position as the required increases in tax revenues to fund operations is projected for many Towns / Counties / Cities in Canada

- Beaver County:
  - The total taxy levy required to fund operations is projected to need to increase about 4.25% yearly through 2021 (ToM 5.6% tax revenue growth at a 3% Mill Rate increase, still tax supported operating deficit)
  - Approximately 65% of projected revenues is from property tax (ToM 46.5% Total, 64.7% excluding utilities)
  - Residential and non-residential Mill Rate is expected to be around 5.5% and 22.2% in 2021
  - Projected operating deficit of about $75k from 2019-2021 (Total surplus of $2M, Tax supported deficit of $4.6M)
- City of Leduc:
  - Approximately 50% of revenue is from Property Tax (ToM 46.5% Total, 64.7% excluding utilities)
  - Debt servicing costs of 4.2% of revenue projected for 2019 (ToM 6.4%, max in base case is 12.4% in 2030 which is half the ACFA debt servicing limit)
  - Expected tax revenue increases of about 5% yearly from 2019-2021 (ToM 5.6% tax revenue growth)
  - Debt limit is 1.5x revenue and debt servicing limit is 0.25x revenue (ToM is 85% of both)
- City of Saskatoon
  - Debt expected to hit $500 million by 2021
  - Debt servicing costs of between 7% and 9% of total revenue between 2016 and 2021
  - Mill Rate increases averaging 5.5% over the last three years

Legend	
ToM in better position than 'other'	⬆ ⬇ (green)
ToM in worse position than 'other	⬆ ⬇ (red)

Net Financial Position – Utility & Operating

- The following graph is the forecasted net annual position of the general operating fund and utility fund
- The utility fund appears to be stable financially, while the general operating fund will face significant financial challenges in the coming years

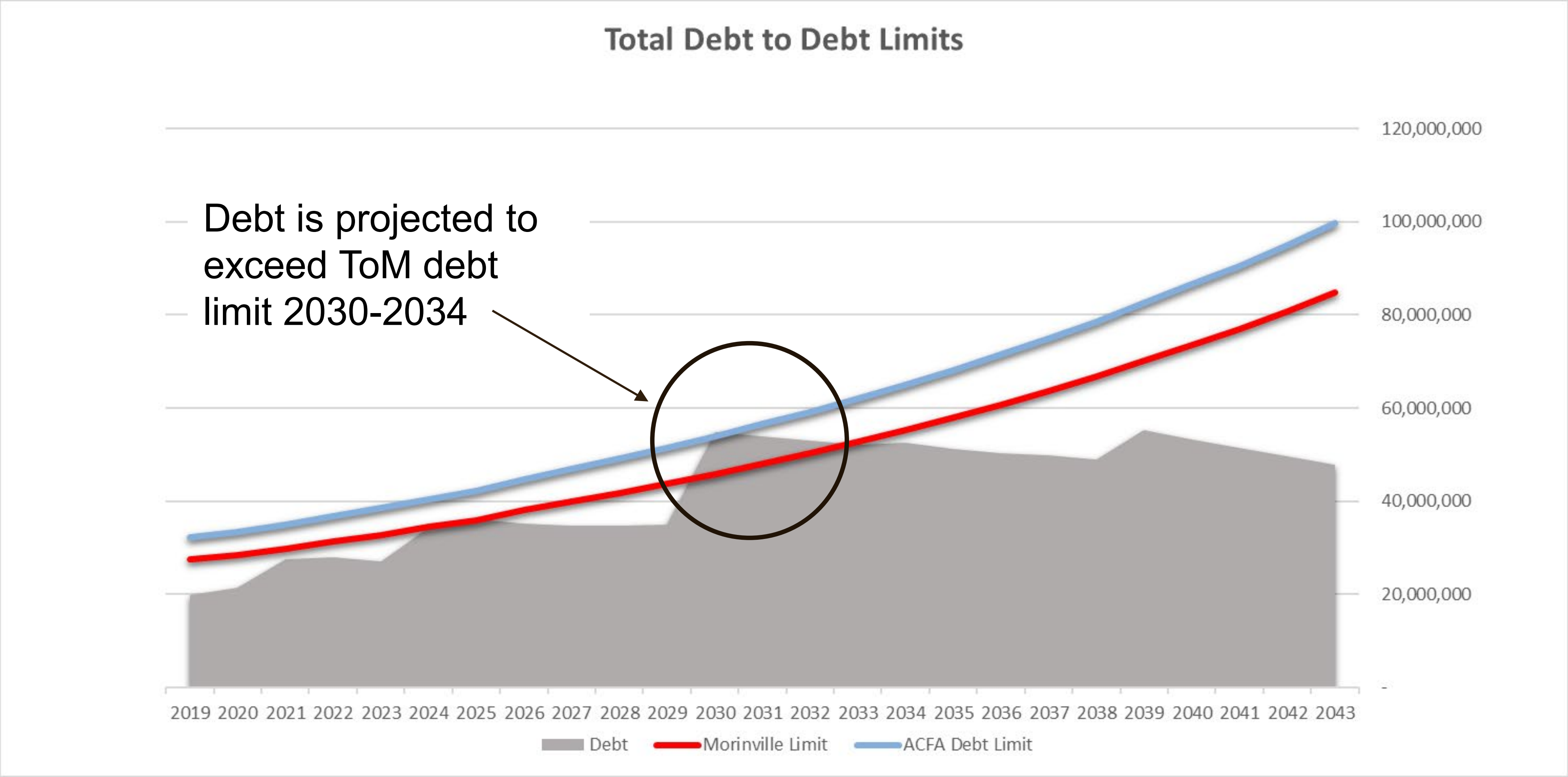


Implication:

Based on the current information Council's goal of a balanced tax supported operating budget within 3 years is unlikely to be achieved. However there is a short and closing window to make key decisions to progress towards that goal.

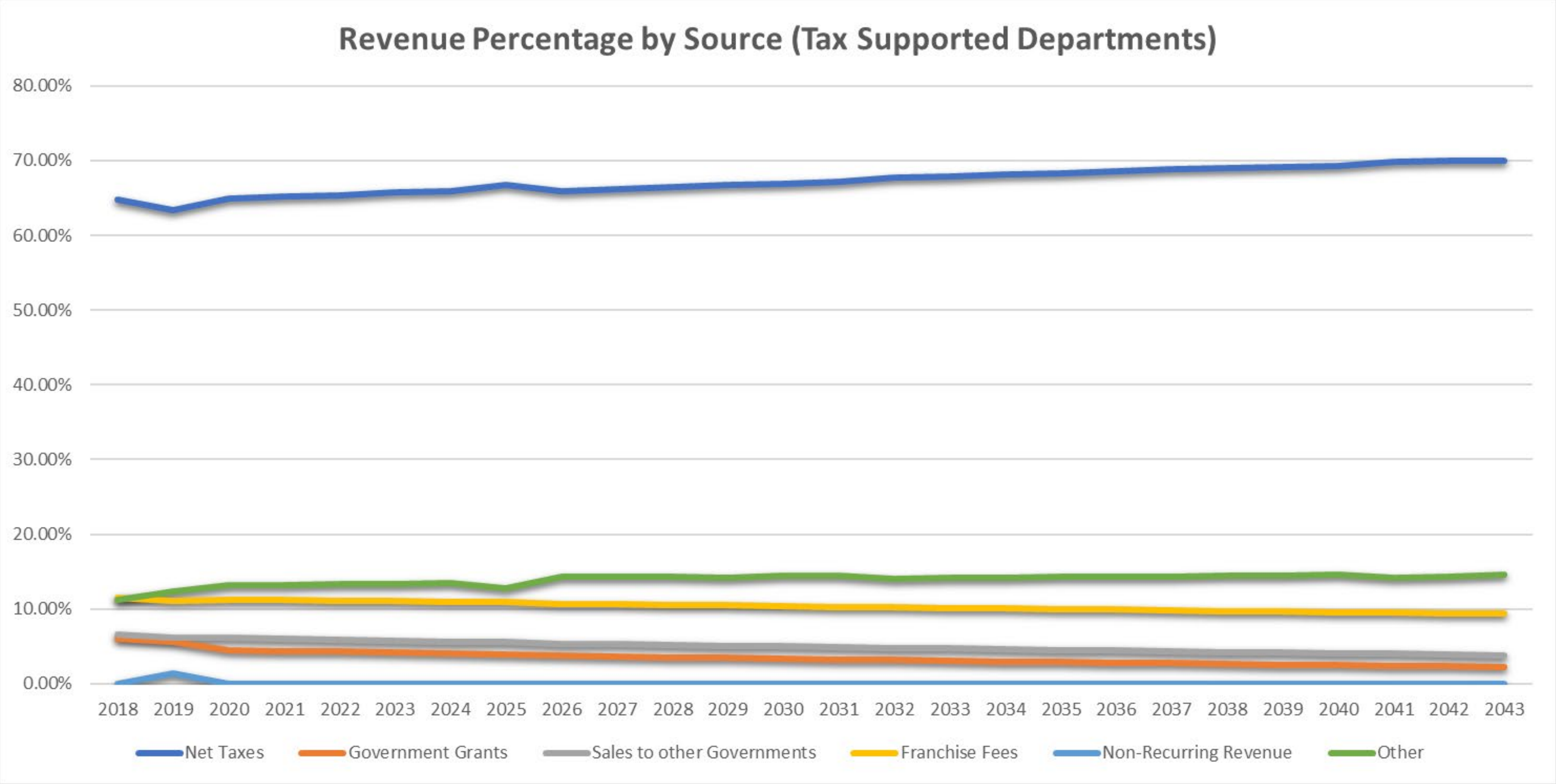
Debt Position

- The following graphs present the total debt vs debt limits and debt per household figures
- The red line is the Town's current debt limit which is most significantly exceeded in 2030 with the addition of the pool, new fire hall and large roundabouts and signals additions
- While total forecasted capital debt does exceed the Town's limit in 2030-2034, the forecasted debt servicing costs do not



Revenue Sources

- Based on the current set of assumptions, the Town will become increasingly reliant on Municipal Taxes as its main source of revenue
- This reliance on a single source of revenue carries significant consequences if household growth or Mill Rate increases are overestimated



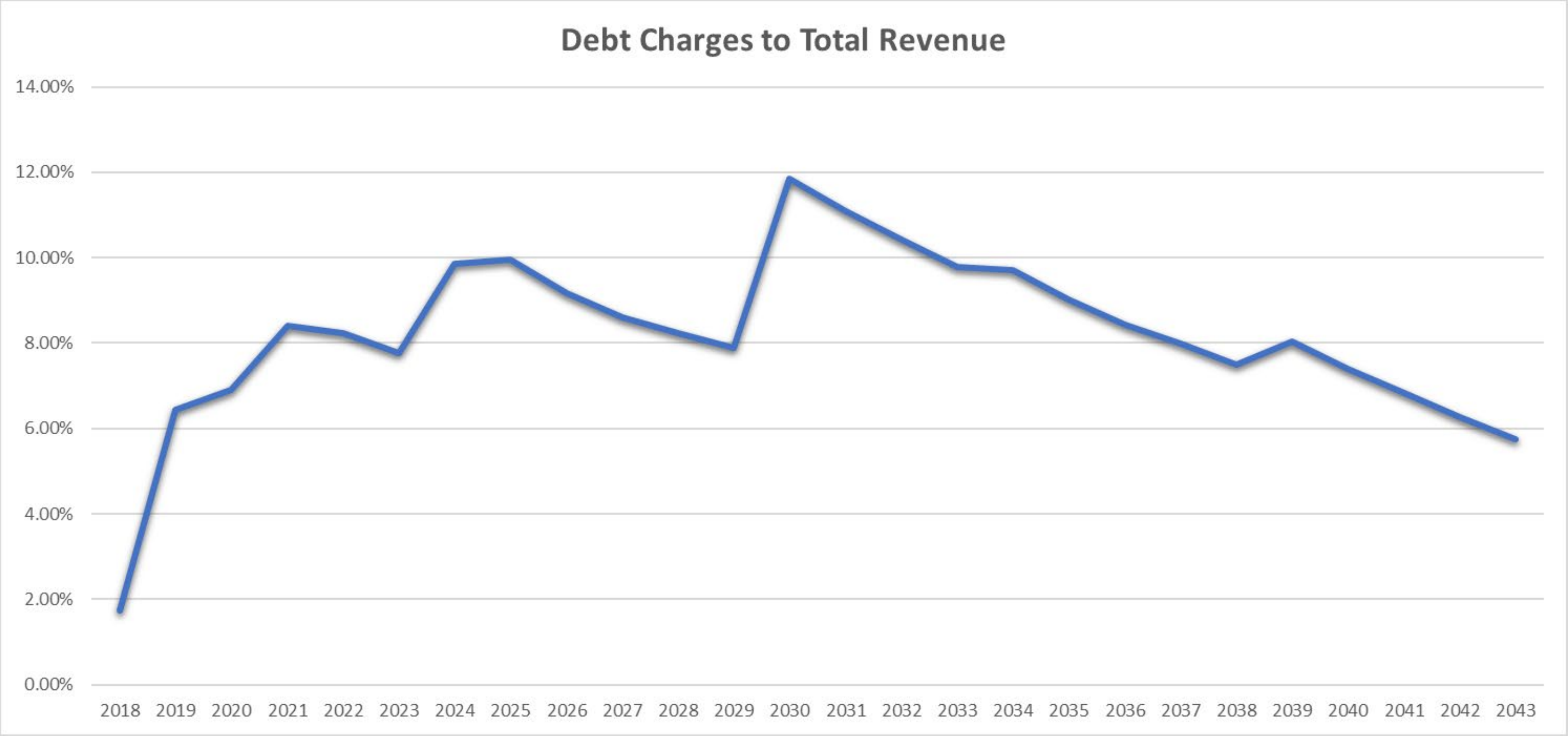
Key Implications:

- A 1% change in the annual Mill Rate increase (e.g. applying a 4% instead of 3% increase) has a $124 million impact on revenue over the life of the model
- Tax revenue rises steadily from 63% to 70% of total tax supported departments revenue while no other single revenue source exceeds 10% in the life of the model
- There is an opportunity to increase ‘other’ revenue sources and decrease reliance on tax revenues

Implications for Financial Sustainability

The model has identified several key risks related to debt:

- Debt related payments peak at about 12% of total revenue in 2030
- The Town's debt capacity is constrained until the end of the model due to current borrowing
- Due to the Town's projected reliance on tax revenue, a small change in either Mill Rate increase or household growth would have a substantial impact on overall financial health
- Other Risks Include:
  - Infrastructure maintenance requirements
  - Reduction in Municipal Operating Grant
  - Higher borrowing costs



Sensitivity Analysis

- The tables below show the total surplus or deficit over the 25-year time horizon of the model based on different levels of rate increases or cuts in costs

- The tables indicate that the Town is expected to have a balanced budget at the base case for each lever. Changes to Mill Rate increases or cost reductions can have significant impacts on surplus (deficit).

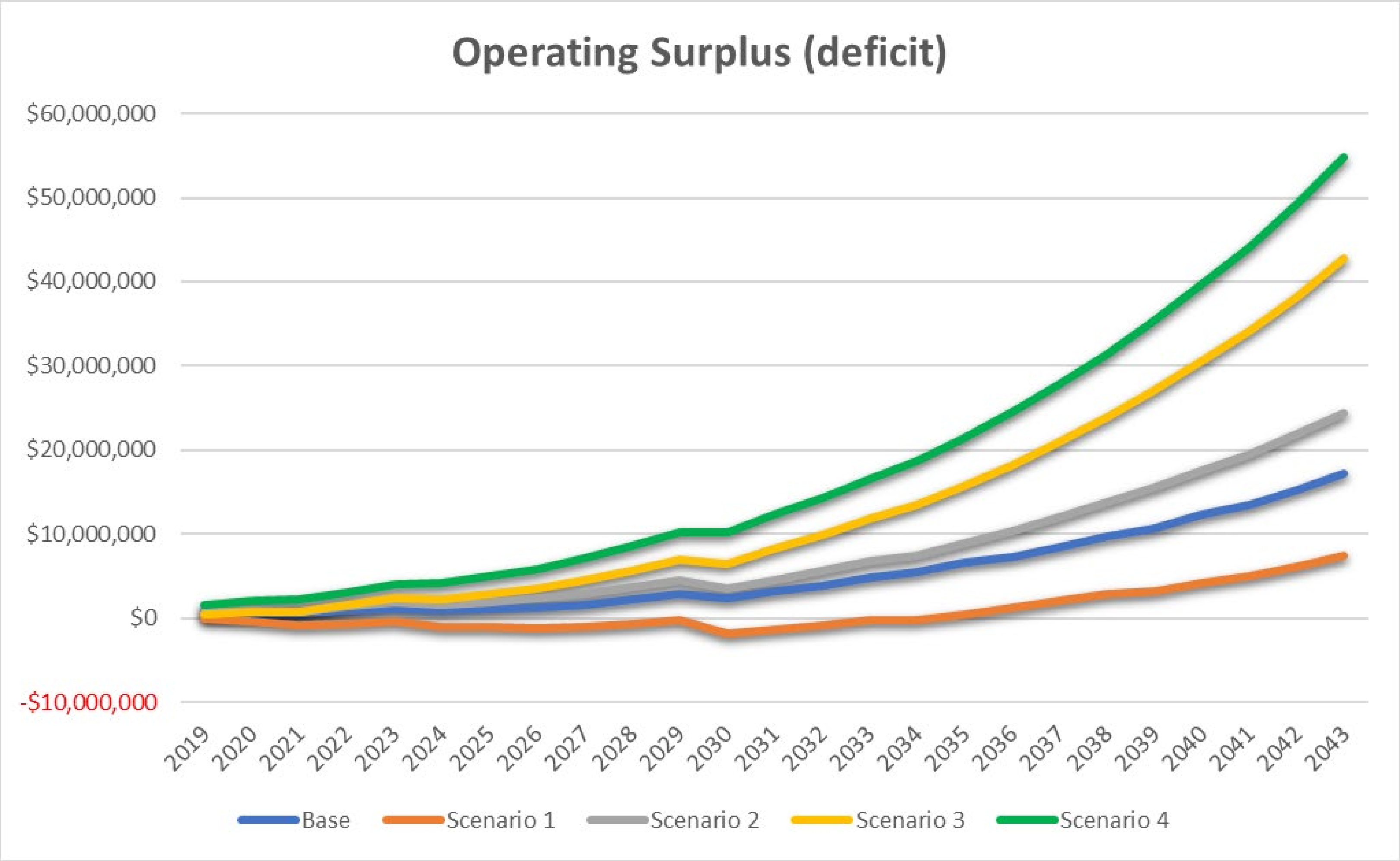
Mill Rate Increase	
Base (Current)	25-Year Total Surplus
3.0%	$134,106,144
2.0%	$50,043,360
2.5%	$87,926,756
3.5%	$172,218,745
4.0%	$220,370,051

Cost Reductions	
Base (Current)	25-Year Total Surplus
0.0%	$134,106,144
2.5%	$159,377,791
5.0%	$183,425,910
7.5%	$208,447,478
10.0%	$234,890,485

User Fees	
Year	25-Year Total Surplus
2.8%	$134,106,144
1.0%	$133,048,721
3.0%	$134,282,018
5.0%	$135,975,177
7.0%	$138,314,988

Scenario Analysis

- For illustrative purpose, four different scenarios were developed and ran within the model. All of which project a total surplus over 25-years
- Only in Scenario 4 will the Town remain below its debt limits throughout the 25-year time horizon of the model
- Except for Scenario 1, all of the scenarios and base case project a total surplus each year (would go into reserves)
- The cost reduction values represent a one-time sustained cost reduction



Scenarios	Tax Increase*	Residential Tax base	Debt Growth	Cost Reduction	User Fees
Base	3.0%	80.6%	0.0%	0.0%	2.9%
Scenario 1	2.0%	83.0%	5.0%	5.0%	5.0%
Scenario 2	3.5%	82.0%	0.0%	4.0%	5.0%
Scenario 3	5.0%	80.0%	0.0%	2.0%	0.0%
Scenario 4	5.5%	85.0%	0.0%	7.0%	2.0%

*Assumption that the property assessment value will not change outside of inflationary pressures and the tax increase is represented by an increase in the mill rate

MNP Observations

- Maintaining debt below mandated levels will require strategic planning by the Town, which could possibly include deferring capital expenditures
- In order to meet future capital requirements, the appropriateness of the Town's current debt limit should be reviewed
- Tax supported departments currently operate at a deficit and are being supported by utility departments' revenues
- The Town is highly dependent on property tax as a revenue source; this makes the Town vulnerable to external factors (e.g. changes in assessment values, population size, competitive factors)

- The LRFM is a dynamic management tool that should not be used to benchmark to the budget

What emerges is an important leadership opportunity …

MNP Recommendations

1. **Council should agree on a set of financial principles to guide decision-making**
   - Financial principles will reaffirm Administration's direction and provide a platform to establish an enterprise-wide financial approach
   - A key principle may be to move towards achieving a balanced tax supported operating budget
   - As an example, the proposed draft Corporate Fee Policy formalizes fee-setting principles around cost recovery, market pricing, and affordability

2. **The Town should select and commit to a long-term combination of "levers"**
   - Anticipated to include a balance of Mill Rate, utility and user fee increases, service levels and, ideally, new revenue sources
   - The results of the Corporate Fee Policy Review has indicated that the Town has room to increase fees in several areas and the review is recommending such
   - It is possible to identify cost savings and operational efficiencies through a suitable operational review

3. **Review the Policies and Plans**
   - Provide management with clarity on the use of the reserves with Council direction
   - The model indicates that the Town could borrow up to the ACFA limit without the principal and interest payments causing financial strain
   - What qualifies as the "LRFP" should be explicitly understood and clearly differentiated from the LRFM *(Plan approved by Council vs. modeling scenarios by Admin)*

4. **Prioritize Long-Term Planning within Town Departments**
   - Understand costs of delivery better; better assess value for money; can lead to improved cost efficiencies between revenues and expenditures
   - Conduct a thorough asset management review in order to prioritize capital needs and improve long-term capital planning

5. **Balance the Overall Community Interest**
   - Need to balance competitiveness, affordability, service need and sustainability in making decisions
   - The model indicates the Town is, and will be, increasingly reliant on property tax as a source of revenue
   - A diversification of revenue streams would reduce the Town's risk and should be a strategic priority