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CORPORATE REPORT

NO: R128 COUNCIL DATE: July 24, 2023

REGULAR COUNCIL

TO:	**Mayor & Council**	DATE:	**July 20, 2023**
FROM:	**General Manager, Finance**	FILE:	**1880-20**
SUBJECT:	**Quarterly Financial Report - Second Quarter – 2023**		

RECOMMENDATION

The Finance Department recommends that Council receive this report for information.

INTENT

The purpose of this report is to provide Council with an update on the City's financial activity for the first two quarters of 2023 and to compare this activity relative to the 2023 Financial Plan.

DISCUSSION

The following discussion provides a summary of the current economic environment including key economic factors globally, nationally, provincially, and within the City, including the continuing financial implications of COVID-19, followed by an outline of Surrey's financial performance through the first two quarters of 2023, in comparison to the Five-Year (2023-2027) Financial Plan which was adopted by Council on April 17, 2023.

Economic Environment and Key Economic Factors

<u>International Overview</u>

Central banks worldwide continued to increase interest rates this year, however, recent rate hikes have not been as dramatic as last year's. With inflation trending down from prior year highs, some central banks have put conditional pauses on further rate increases, contingent on economic data results. The global economy is still facing high inflation despite the rapid pace of interest rate increases over the last 18 months. Central banks are facing challenges fighting price level increases with the broader inflation rate falling steadily but core inflation, which strips out volatile items, remains higher than central banks targets. Price pressures are varied across goods and services, if core inflation shows no further signs of deceleration, central banks will be forced to take further action.

The International Monetary Fund ("IMF") warns that it may take central banks longer to get inflation down to targeted levels due to a tight labour market and inflation in services remaining high. The IMF strongly urged central banks to keep tightening monetary policies or risk having inflation entrenched in their economies. The fund warns that a return to the low interest rates seen pre-pandemic is highly unlikely, thus, businesses and consumers should adjust expectations accordingly.

The European Central Bank ("ECB") raised its main refinancing operations rate for the eighth consecutive time this June, bringing its benchmark interest rate to 4.0%, the highest level since 2008. The ECB signalled that it will continue to raise interest rates to lower inflation and to tame expectations of future price increases. The ECB's key interest rate is anticipated to increase by a further 0.25% at the end of July. The Eurozone's headline inflation came in at 6.1% in May 2023, with core inflation coming in at 5.3%. Despite a recent slow down in inflation, the central bank felt further rate increases are warranted as it is forecasting inflation to come in at 5.4% this year and 3.0% next year. The Eurozone entered into recession in the first quarter of 2023 with Gross Domestic Product ("GDP") coming in at -0.1%. The central bank is forecasting the Eurozone economy to grow at 0.9% this year and 1.5% next year.

The persistent inflation in the United Kingdom ("UK") prompted the Bank of England ("BOE") to raise its key interest rate by 0.50% in June, surpassing market expectations of a 0.25% increase. In May, headline inflation came in at 8.7% with core inflation at 7.1%. The UK's inflation rate peaked last October at 11.1% and has decelerated since, but not as quickly as other major international peers. The UK now has the highest inflation rate amongst G7 countries. The UK government met with major UK banks to encourage the banks to relax mortgage repayment terms allowing households to better manage their debt.

<u>United States Overview</u>

The US economy and labour market continues to show resiliency despite high interest rates. Economists had expected a slow down in job creation as consumers and businesses cut consumption and investments due to higher borrowing costs. US GDP grew by annualized rate of 2.0% in the first quarter due to strength in consumer consumption and exports. The labour market added 339,000 jobs in May and the unemployment rate increased to 3.7%, inching up from last month's historic low of 3.4%.

During it's June meeting, the US Federal Reserve ("Fed") kept its benchmark interest rate range at 5.00% to 5.25%. Prior to this pause, the central bank had raised its key interest rate 10 consecutive times over the past year. US mortgage rates fell slightly since the announcement of the rate pause by the Fed, with the 30-year mortgage rate slipping from its 2023 high of 6.79% to 6.69%.

The year-over-year annual headline inflation rate dropped to 3.0% in June, the slowest annual gain since March 2021, while core inflation came in at 4.8%. Although core inflation has been edging downward, the rate remains stubbornly high due to increases in rent, used cars, healthcare, and insurance. The Fed is closely monitoring core inflation and assessing the impact of interest rate hikes and regional banking stresses on the economy.

The US central bank will be looking for moderation in consumer spending and the employment rate for signs that interest rate hikes are having the desired effects. The Fed Chair indicated, based on current data on core inflation, two or more interest rate increases this year would be necessary to bring inflation to its targeted level. The timing and extent of the rate increases will be dependent on upcoming economic data.

Canadian Overview

Economists had forecasted the Bank of Canada's ("BOC") aggressive rate increases to cause a mild recession as early as the end of 2022. The Canadian economy continues to show resiliency, expanding by an annualized rate of 3.1% in the first quarter, surpassing the central bank's forecast of 2.3% growth.

The unemployment rate came in at 5.2% in May and then ticked up to 5.4% in June, the first increases in unemployment since last August where the unemployment rate was at 5.4%. The average hourly wage increased by 4.2% in June compared to the same period last year. Wage increases have outpaced inflation in the last few months due to the tight labour market. The BOC warns that continued growth in wages without declines in employment will make it difficult to return inflation back to its targeted level.

In April, inflation rose to 4.4%, the first increase in annual inflation since June of last year. The rise in inflation and strong wage growth prompted the BOC to act. The central bank increased its benchmark interest rate by 0.25% in June and once again by 0.25% in July, bringing the key rate up to 5.0%, the highest level since 2001. The central bank indicated in January of this year that it would conditionally pause interest rates to assess the impacts of previous rate hikes on the economy. The BOC's rate hike in June was not widely expected. The central bank felt a June rate hike was necessary due to a resurgence in household spending, slowdown in disinflationary momentum and a strong labour market. The BOC had stated that businesses pricing behaviour and workers wage expectations are fueling inflation. The BOC hopes to signal to businesses and workers that the central bank is committed to bringing inflation down and that price growth expectations should be reined in.

In June, inflation decelerated to a 27-month low of 2.8% due to gasoline prices falling by 22% from a year earlier. Excluding food and energy, prices rose 3.5% compared with a year earlier. The cost of living remains high with grocery prices going up by 9.1% and the mortgage cost index rising by 30% from the prior year.

The tightening of monetary policy has not slowed down consumer spending due to the build up of savings during the pandemic. In April, retail sales grew 1.1% from the prior month. The preliminary reading for consumer spending indicates there is no slowing of activity in the subsequent months. The effects of higher financing costs will take some time to work their way through the economy. The BOC estimates that over the next few years two-thirds of mortgages will come up for renewal. Over time, households discretionary spending will lessen due to higher mortgage and housing costs which will weigh down the demand for goods and services and lead to price stability.

British Columbia Overview

British Columbia's ("BC") unemployment rate came in at 5.6% in June with 2,600 jobs lost province-wide. BC's job losses were mostly seen in the construction, retail/wholesale, and transportation sectors, offset by gains in health care, manufacturing and finance/real estate.

BC's annual inflation ticked up slightly in June to 3.5%. BC's inflation rate has outpaced Canada's rate of inflation for the past year.

British Columbians are the most affected by the increases in interest rates due to high housing costs. BC's households have higher household debt relative to other provinces due to high home prices. The renewal of mortgages at higher interest rates will drag down consumer consumption as the amount available for discretionary spending goes down. The Royal Bank of Canada ("RBC") is forecasting that due to higher debt servicing costs, BC retail sales will grow at 0.4% this year, lagging behind other provinces. The slowdown in retail sales will prompt businesses to reduce hiring.

RBC is forecasting BC's GDP growth to lag behind other provinces this year with the provincial economy forecasted to grow at 0.6%. RBC is expecting a slowdown in construction and business investments to impact the job market, reflected through a forecasted unemployment rate of 5.3%. Over the coming months, as the labour market softens, wage growth is expected to decelerate.

The BC Real Estate Association is reporting home sales are showing signs of resurgence despite rising interest rates. June home sales rose by 21% year-over-year in Metro Vancouver and by 52% in the Fraser Valley. The recovery has been attributed to strong demand and shrinking housing inventory. The BC real estate market is an important contributor to the economy with estimates showing that 30% of the province's economic output is connected to the housing market.

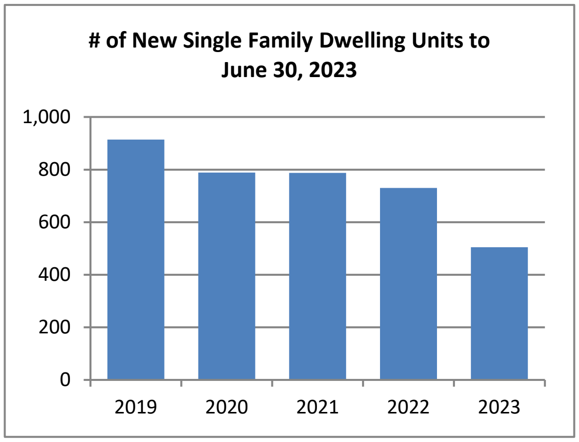
City of Surrey Overview

In the residential development category, the City has seen a decrease in construction of new single-family dwelling units, whereas multi-family development activity has remained strong in this six-month period as compared to the same period in 2022. In the non-residential development category, as compared to 2022, the City has seen a decrease in the number of permits in Industrial, Commercial & Institutional ("ICI") development segments.

Overall, rising interest rates and the resulting increase in mortgage costs have had a cooling effect on real estate construction in the region. This has resulted in a moderate slowdown in overall development activity in the City.

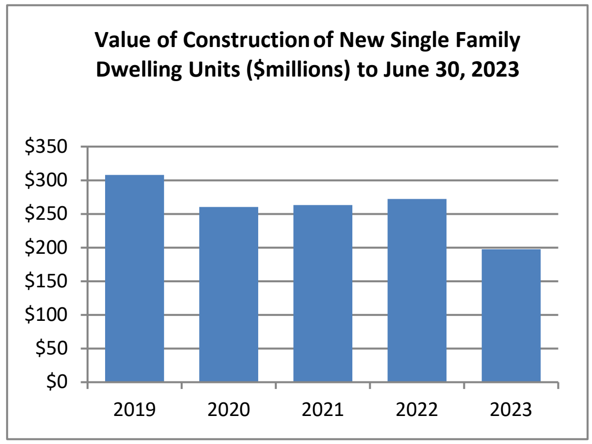
City of Surrey's Key Performance Indicators

The following graphs show data for the first six months of 2023 compared to previous years.



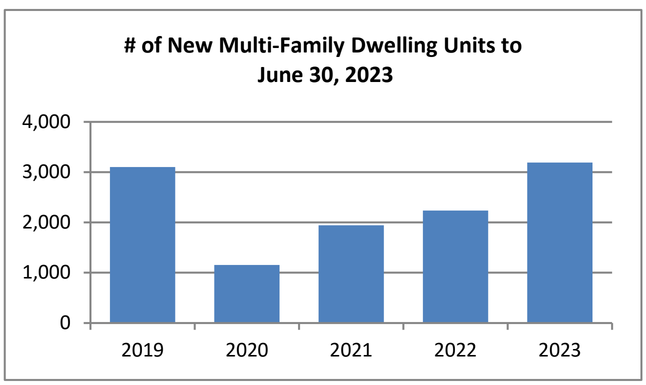
Graph 1

Due to a continued shift in residential development activity from single-family to multi-family, new single family dwelling units have declined by 31% in this six-month period, as compared to the same period in 2022.



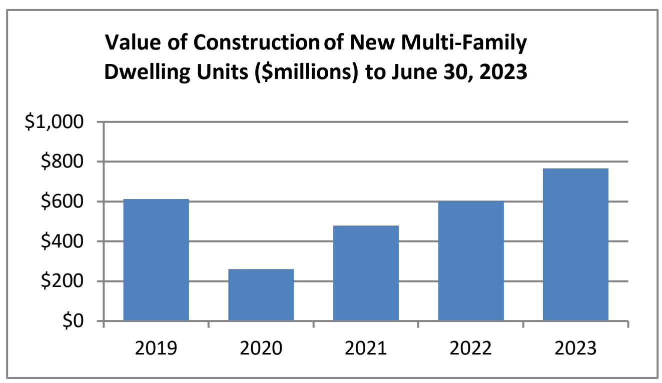
Graph 2

Due to a decline in the number of permits issued for new single-family dwelling units in this six-month period as compared to the same period last year, the value of construction of these units has correspondingly decreased by 27% when compared to the same period last year.



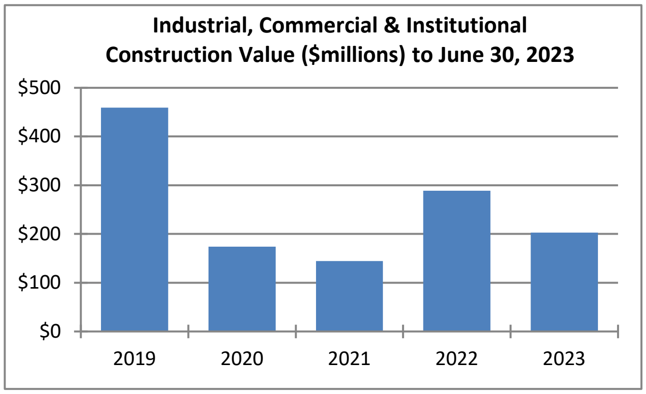
Graph 3

As discussed above, there has been an overall increase in development activity in multi-family residential projects. This six-month period has seen an increase in permits for multi-family dwelling units by 43%.



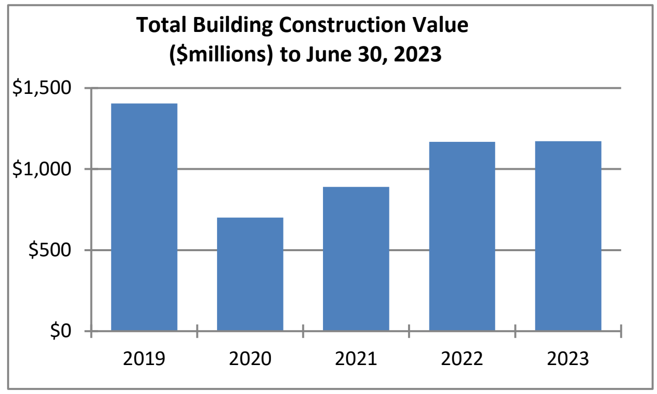
Graph 4

Consistent with an increase in the number of permits issued for new multi-family dwelling units in this six-month period as compared to the same period last year, the value of construction for these units has increased by 27% when compared to the same period last year.



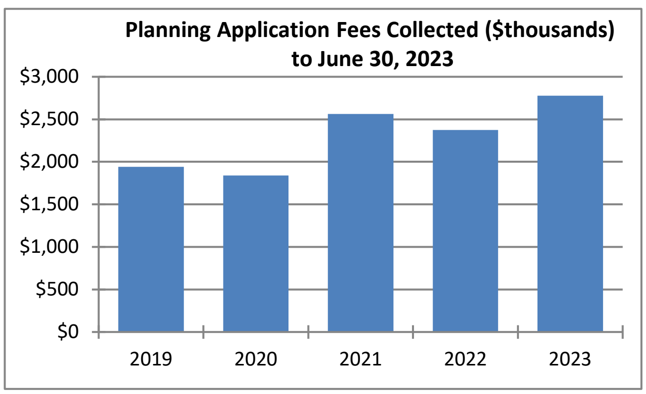
Graph 5

Construction value of ICI permits for the first six months of 2023 is lower by 30% as compared to the same period in 2022. This is primarily due to some significantly large projects that received permits in the first two quarters of 2022, such as a large industrial warehouse project in Campbell Heights and a multi-story industrial warehouse project, with office and parking spaces, in Panorama Ridge.



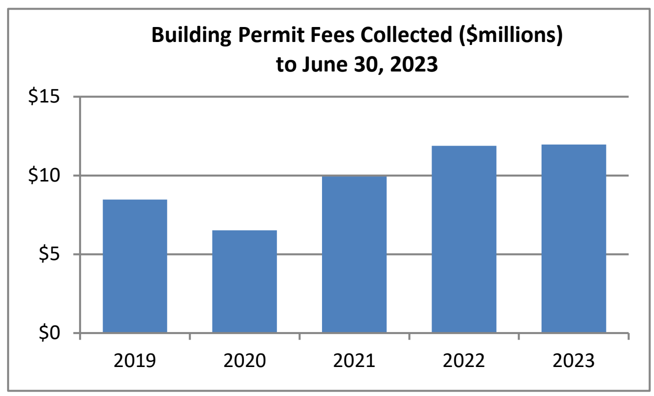
Graph 6

Due to an increase in the construction values associated with multi-family residential permits, offset by a decrease in values of construction associated with single-family residential and ICI projects, the total building construction value in the City year-to-date is unchanged as compared to the same period last year.



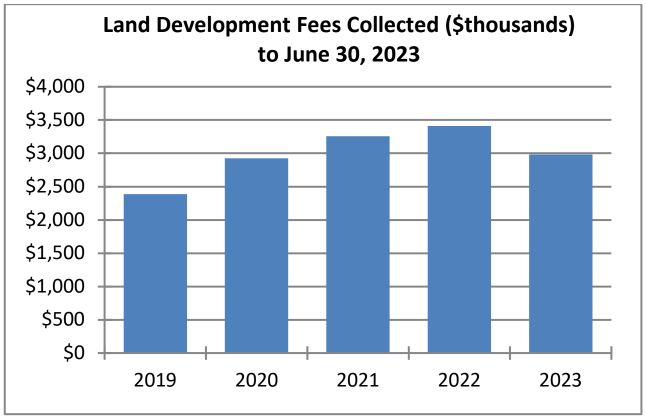
Graph 7

Although the past three months have seen an overall slowdown in development activity, planning application fees collected in the first six months were 17% higher as compared to those collected in the same period last year.



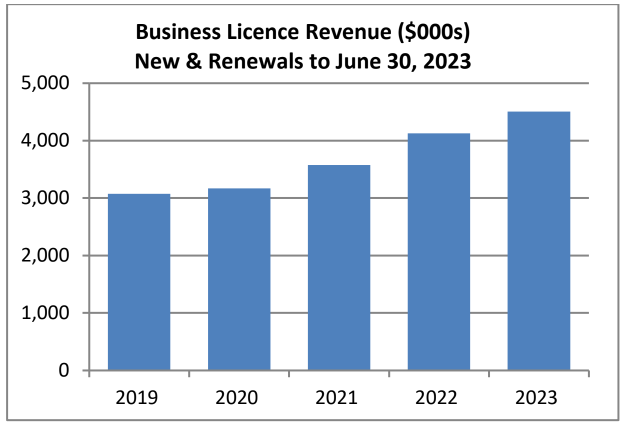
Graph 8

Since the total building construction value in the City year-to-date is unchanged as compared to the same period last year (as reflected in Graph 6), building permit fees collected in this six-month period as compared to the same period last year are also unchanged.



Graph 9

Land Development fees collected during the first six months of 2023 are lower by 13% as compared to the same period in 2022. Overall, this pace of fee collection is consistent with the average land development fees collected in the first six months of the four preceding years.

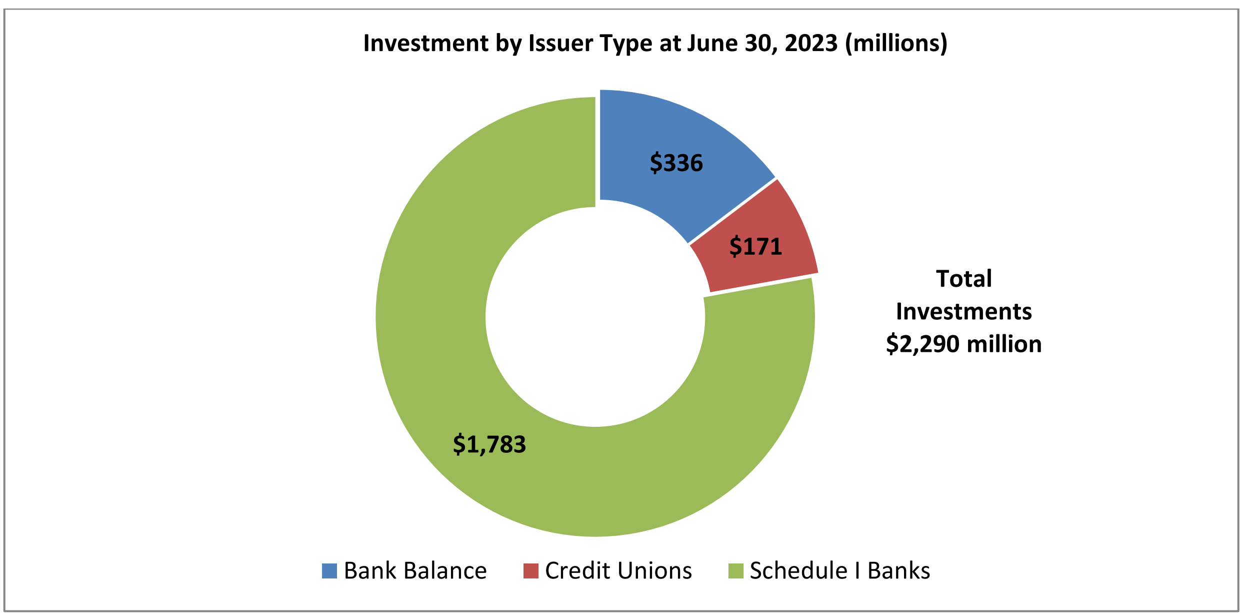


Graph 10

Consistent with increases over the last few years, business license revenue in the first six months of 2023 increased by 9.0% as compared to the same period last year. This increase aligns with a 7.0% increase in the number of businesses paying for business licences in Surrey in this six-month period as compared to 2022.

City Investment Portfolio

The City invests public funds in a prudent manner, providing investment return and long-term security while meeting daily cash flow needs. The investment portfolio is currently valued at $2,290 million. Most of these funds have either been committed to specific capital projects or are funds that have been invested until they are needed to pay current operating expenses. Graph 11 shows the City's Investment Portfolio by issuer type.

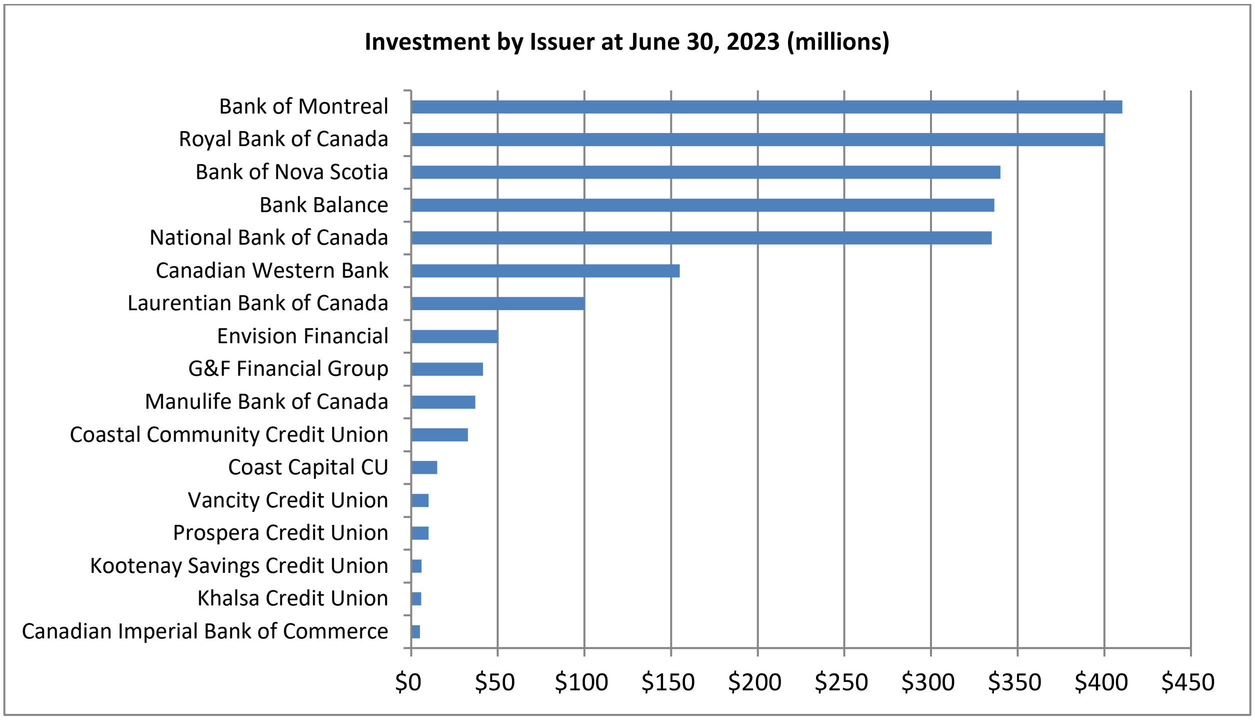


Graph 11

Investments within the portfolio are managed within the framework of the City's Investment Policy. Objectives of the Policy include:

Diversification

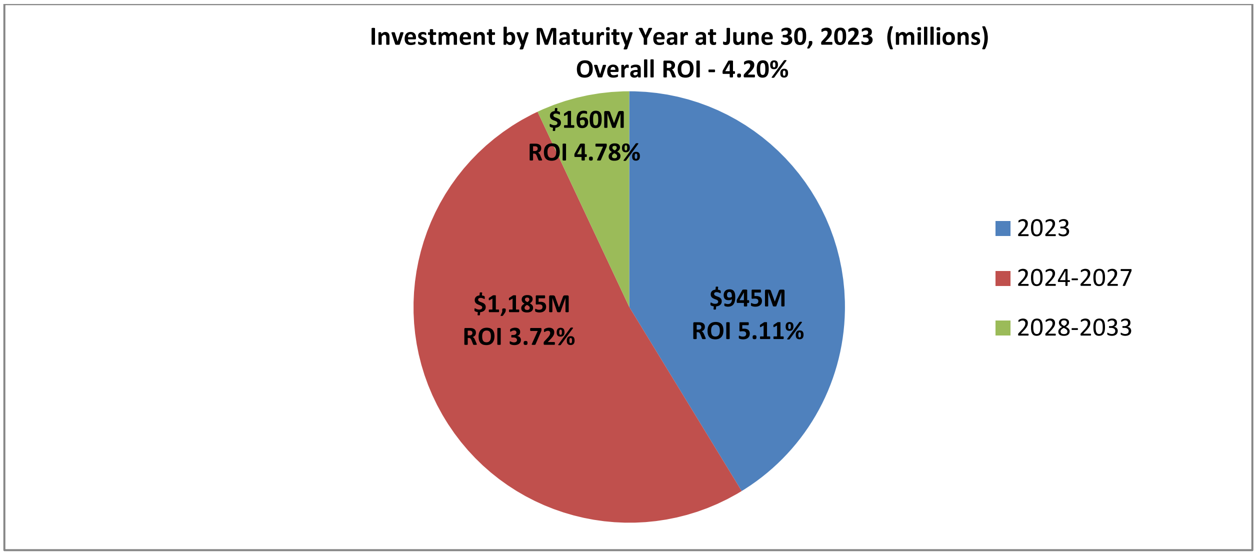
In order to reduce overall portfolio risk, the City diversifies its investment holdings across a range of security types and financial institutions. Graph 12 shows a listing of the City's portfolio by Financial Institution.



Graph 12

Liquidity

The City ensures that the investment portfolio remains sufficiently liquid in order to meet all reasonably anticipated operating and capital cash flow requirements. Maturities coincide with cash requirements, as much as reasonably possible. The investment portfolio is managed through the laddering of investment maturities to account for the timing of cashflow demands. The City's forecasted cash balances are currently in a healthy position with efforts ongoing to remain prepared as new information is incorporated into the cashflow forecast. In the event the City's cash flow requirements change drastically, we are well positioned to add liquidity as necessary. Graph 13 shows the portfolio by maturity terms.



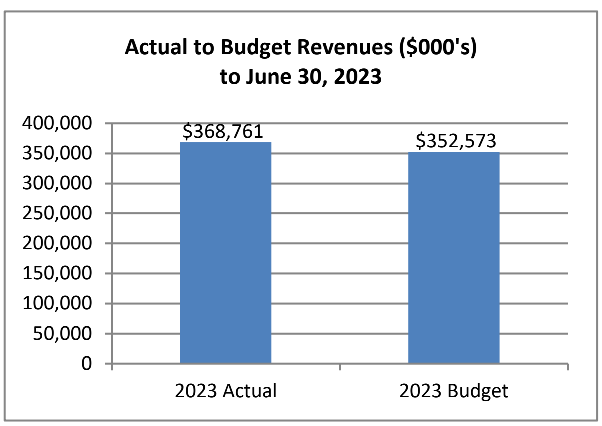
Graph 13

Return on Investment

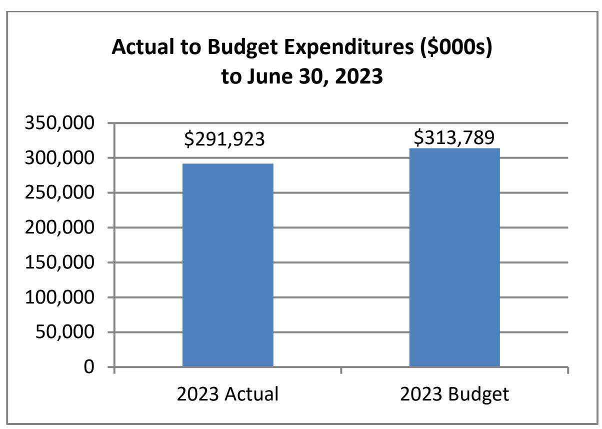
During the six-month period ending June 30, 2023, the City's investment portfolio earned a combined rate of approximately 4.20% (during the six-month period ending June 30, 2022 – 1.88%) while maintaining investment security as outlined in the City's investment policy. The City strives to earn a reasonable rate of return on the investment portfolio throughout varying budgetary and economic cycles, taking into account investment risk constraints and liquidity needs.

Actual Revenues and Expenditures Relative to the Budget (Financial Plan)

The following graphs illustrate the variances between the actual and the budgeted operating revenues and expenditures respectively, excluding transfers, for the first quarter of 2023.



Graph 14



Graph 15

Appendix "I" documents the General Operating Fund's revenues and expenditures at the end of second quarter of 2023 at a more detailed level. Departments are proactively monitoring their actual results on a monthly basis. The following section provides an explanation on a Department-by-Department basis of year-to-date variances in relation to the 2023 budget and as shown in Appendix "II".

Policing Services

In June, Council voted to reaffirm their decision to retain the RCMP as the police of jurisdiction ("POJ"). The City's most recent corporate report outlining the plan to retain the RCMP as POJ was submitted to the Provincial Minster of Public Safety and Solicitor General ("Minister") as requested.

On July 19th, 2023, the Minister directed the City to move forward with the transition to the Surrey Police Service ("SPS"). The Province's directive was issued under the Minister's interpretation of the Police Act. As part of the announcement, the Minister appointed a strategic implementation advisor and re-committed to providing the City with $150 million to help offset the costs of moving forward with the SPS. City staff will work with Mayor and Council to further understand the basis on which this directive was issued and the financial implications for the City.

In relation to the adopted Q2 budget for Policing Services, the following is the variance for each of the three components:

- ***City Police Support Service*** currently has a favourable variance of $1.3 million primarily due to revenue from security clearance being higher than the budget, and cost savings due to timing of operating costs.

- ***Surrey Police Service*** ("SPS") currently has a favourable variance relative to budget of $13.5 million primarily due to and savings from salaries and operating costs due to difference between the budgeted and the hired SPS members.

- ***RCMP Contract*** currently has a favourable variance of $8.5 million primarily due to timing of operating costs and savings from salaries.

Given the Minister's direction to continue with the SPS occurred at the same time as finalization of this report, it is imperative for Council to understand that the favorable year to date variance as shown in this report is indicative of the conditions in place prior to the issuance of the Minister's directive. The potential savings or deficit for Policing Services for the remainder of this year is currently uncertain, staff will provide further information in the Third Quarter Financial Report.

Fire Department currently has a favourable variance of $416,000, primarily due to timing of the hiring of 20 approved new Fire personnel positions in 2023.

Engineering Services-General Operating currently has a favourable variance of $714,000, primarily due to higher-than-expected land development revenues, staff vacancies and timing of operating costs.

Parks, Recreation & Culture ("PRC") Department currently has a favourable variance of $1.2 million. This is primarily due to vacancies and timing of expenditures and due to an unbudgeted grants received from another level of government.

Surrey Public Library currently has a favourable variance of $195,000, due to timing of operating costs and savings from vacancies.

Planning & Development Department which also includes Civic Facilities, currently has a favourable variance of $2.9 million. Since Planning & Development revenues are recognized up to a two-year period, permit, inspection, and application revenues in this year are favourable due in part to better-than-expected permit and planning application fees collected in 2021/2022 that are, in part, being recognized as revenue in 2023.

Mayor and Council has a favourable variance of 68,000, resulting from timing of expenditures and savings in operating costs.

City Grants are on budget at the end of second quarter.

City Manager's Department has a favourable variance of $206,000 primarily due to timing of operating costs and savings from vacancies.

Community Services Department currently has a favorable variance of $322,000, primarily due to timing of operating costs and savings from vacancies.

Investment & Intergovernmental Relations Department currently has a favourable variance of $162,000, primarily due to savings from vacancies.

Finance Department currently has a favourable variance of $125,000, primarily due to timing of operating costs and savings from vacancies.

Corporate Services Department has a favourable variance of $322,000 due to better-than-expected business license revenues, timing of operating costs and savings from vacancies.

CONCLUSION

Although, relative to the adopted budget for the first six months of the year, actual results are favorable, it is important for Council to understand that staff will need to conduct due diligence in relation to the financial impact of the Minister's direction pertaining to the Policing Transition. Given the overall magnitude of the Policing operations budget, any significant variance for the reminder of the year would certainly have an impact on the overall City's operating budget results.

Staff will provide further information in the Third Quarter Financial Report to Council.

Kam Grewal, CPA, CMA
General Manager, Finance

Appendix "I": 2023 Second Quarter Council Report, Executive Summary - Revenues & Expenditures
Appendix "II": 2023 Second Quarter Council Report, Departmental Detail

Appendix "I"

2023 2nd QUARTER COUNCIL REPORT
EXECUTIVE SUMMARY - REVENUES & EXPENDITURES
$ 000's

REVENUE SUMMARY	2023: 2nd Qtr YTD Actual	2023 YTD BUDGET	2023: 2nd Qtr YTD Variance	2023 ANNUAL BUDGET
Net Taxation	251,157	250,443	714	507,917
Secondary Suite Infrastructure Fee	14,445	13,968	477	24,931
Other Corporate Fees	2,192	2,200	(8)	4,400
Investment Interest	29,000	23,400	5,600	57,336
Provincial Casino Revenue Sharing	1,654	1,654	-	3,308
Carbon Tax Rebate	588	588	-	1,175
Other Trsf from Government	-	-	-	18,176
Penalties & Interest on Taxes	418	204	214	5,275
Corporate Leases	6,171	6,573	(401)	13,145
Non-Tax Revenues	54,468	48,585	5,883	127,746
Program Revenues	63,136	53,545	9,591	98,025
TOTAL REVENUES	368,761	352,573	16,188	733,688

EXPENDITURE SUMMARY	2023: 2nd Qtr YTD Actual	2023 YTD BUDGET	2023: 2nd Qtr YTD Variance	2023 ANNUAL BUDGET
Program Expenditures, net of transfers	283,361	303,748	20,388	682,153
Council Priorities	51	130	79	260
Fiscal Services	(22)	83	105	167
Debt Interest & Principal	7,408	7,408	-	31,243
Other	1,125	2,419	1,294	23,063
TOTAL EXPENDITURES	291,923	313,789	21,867	736,886

CORPORATE TRANSFER SUMMARY	2023: 2nd Qtr YTD Actual	2023 YTD BUDGET	2023: 2nd Qtr YTD Variance	2023 ANNUAL BUDGET
Transfer to /(from) Operating Sources	(9,037)	(9,037)	-	(18,074)
Transfer to /(from) Capital Sources	1,523	-	(1,523)	(15,435)
Transfer to /(from) Reserve Sources	7,498	7,498	-	14,996
Transfer to /(from) Surplus	5,997	7,658	1,661	15,315
TOTAL TRANSFERS	5,981	6,119	137	(3,198)
Surplus (Deficit)	70,857	32,665	38,192	-
Trsf (To)From Unapprop Surplus	(70,857)	(32,665)	(38,192)	-
BALANCED BUDGET	-	-	-	-

2nd Quarter YTD Actual to Budget Variance: $ 38,192

Appendix "II"

2023 2nd QUARTER COUNCIL REPORT
DEPARTMENTAL DETAIL
$ 000's

PROGRAM REVENUES	2023: 2nd Qtr YTD ACTUAL	2023 YTD BUDGET	2023: 2nd Qtr YTD Variance	2023 ANNUAL BUDGET
City Police Support Service	4,789	4,541	248	8,082
Surrey Police Service	-	-	-	-
RCMP Contract	-	-	-	-
Fire	829	683	146	3,991
Engineering Services	6,637	6,034	603	8,946
Parks, Recreation & Culture	18,236	17,817	419	35,211
Surrey Public Library	797	697	100	1,386
Planning & Development	20,189	17,130	3,060	28,258
Mayor & Council	-	-	-	-
City Grants	-	-	-	-
City Manager	-	-	-	-
Community Services	4,895	-	4,895	-
Invest. & Intergovernmental Relations	-	-	-	-
Finance	646	755	(109)	1,462
Corporate Services	6,117	5,888	229	10,689
TOTAL PROGRAM REVENUES	**63,136**	**53,545**	9,591	**98,025**

PROGRAM EXPENDITURES NET OF TRANSFERS	2023: 2nd Qtr YTD ACTUAL	2023 YTD BUDGET	2023: 2nd Qtr YTD Variance	2023 ANNUAL BUDGET
City Police Support Service	16,094	17,182	1,088	124,071
Surrey Police Service	32,327	45,801	13,474	48,751
RCMP Contract	69,722	78,196	8,474	165,225
Fire	35,665	35,936	270	79,467
Engineering Services	6,995	7,106	111	13,968
Parks, Recreation & Culture	50,317	51,127	810	110,651
Surrey Public Library	10,902	10,997	95	22,692
Planning & Development	18,071	17,948	(124)	36,389
Mayor & Council	988	1,056	68	2,123
City Grants	635	635	-	1,179
City Manager	647	853	206	1,712
Community Services	6,256	1,683	(4,573)	3,921
Invest. & Intergovernmental Relations	685	847	162	2,050
Finance	7,379	7,612	234	15,443
Corporate Services	26,677	26,770	93	54,511
TOTAL PROGRAM EXPENDITURES	**283,361**	**303,748**	20,388	**682,153**

NET PROGRAM	2023: 2nd Qtr YTD ACTUAL	2023 YTD BUDGET	2023: 2nd Qtr YTD Variance	2023 ANNUAL BUDGET
City Police Support Service	11,305	12,641	1,336	115,989
Surrey Police Service	32,327	45,801	13,474	48,751
RCMP Contract	69,722	78,196	8,474	165,225
Fire	34,836	35,253	416	75,476
Engineering Services	358	1,072	714	5,022
Parks, Recreation & Culture	32,081	33,310	1,229	75,440
Surrey Public Library	10,105	10,300	195	21,306
Planning & Development	(2,118)	818	2,936	8,131
Mayor & Council	988	1,056	68	2,123
City Grants	635	635	-	1,179
City Manager	647	853	206	1,712
Community Services	1,361	1,683	322	3,921
Invest. & Intergovernmental Relations	685	847	162	2,050
Finance	6,732	6,857	125	13,981
Corporate Services	20,560	20,882	322	43,822
NET PROGRAM TOTAL	**220,225**	**250,204**	29,979	**584,128**