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CORPORATE REPORT

NO: R085 COUNCIL DATE: May 13, 2019

REGULAR COUNCIL

TO:	**Mayor & Council**	DATE:	**May 6, 2019**
FROM:	**General Manager, Finance**	FILE:	**1880-20**
SUBJECT:	**Quarterly Financial Report - First Quarter - 2019**		

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 quarter of 2019 and to compare this activity with the 2019 Financial Plan and the same period in 2018.

DISCUSSION

The Five-Year (2019-2023) Financial Plan was adopted by Council on December 19, 2018.

The following discussion provides a summary of the current economic environment including key economic factors, highlights of the Provincial Government's 2019 budget, followed by an outline of Surrey's financial performance for the first quarter of 2019. It also includes an overview of the City's investment portfolio performance.

Economic Environment and Key Economic Factors

International Overview

The International Monetary Fund ("IMF") is forecasting the global economy to grow by 3.5% this year. The agency continues to urge world leaders to address high levels of public debt which will constrain countries' abilities to act in the next economic downturn. The IMF cites the ongoing United States of America ("US")-China trade war, Brexit and a slowing global economy as major risks. The ongoing trade war between the world's two largest economies has spillover effects on the rest of the world; IMF estimates the worldwide trade volume will be reduced by 4% this year.

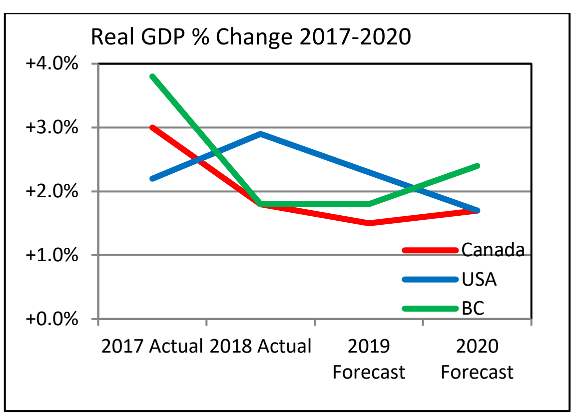
Oil prices have been supported by production cuts by the Organization of the Petroleum Exporting Countries ("OPEC") but prices fell below $60 USD per barrel in late March as manufacturing data from Asia, Europe, and the US points to a slowdown in the economy. There are increased concerns a global economic slowdown will lead to inventory buildups which will put downward pressure on prices.

Investors' concerns of a slowing global economy, coupled with expectations that the US and Canadian central banks will put interest rates on hold this year, caused investors to pour funds into long term government bonds. Increased demand pushed down the yield causing 10-year government bonds to come in lower than short term bonds. The US and Canada yield curve inverted in late March; analysts watch the yield curve closely as it is a warning sign for the onset of recession.

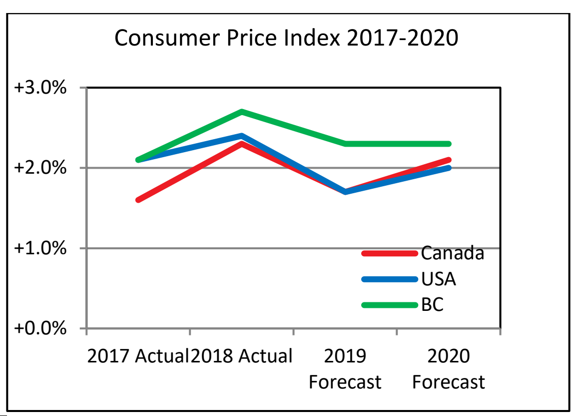
The European Central Bank ("ECB") revised its Gross Domestic Product ("GDP") forecast downward to 1.1% and inflation to 1.2% for 2019. The ECB announced that interest rates will hold on until at least the end of this year. The central bank cites slowdown in international demand and increased protectionism as a threat to Eurozone growth. Uncertainties surrounding the United Kingdom's ("UK") exit from the European Union ("EU") and ongoing US-China trade disputes could further weigh down the economy.

The date for the UK to leave the EU has passed. The UK was granted an initial extension to allow its legislatures time to break the deadlock on Brexit. The deal negotiated by Prime Minister May was voted down three times in parliament. Eight other alternatives to the negotiated deal were presented, but none garnered majority support. In April, EU leaders granted a further six-month extension to the UK, providing them until Oct 31 of this year to depart from the EU. The postponement means Britain is now preparing to participate in elections for the European Parliament, scheduled for May 23.

China's economy is expected to slow down this year with GDP forecasted between 6%-6.5%. Last year, China experienced the slowest economic growth in three decades. The Chinese economy is reaching maturity with household and national debts reaching the levels that are similiar to other developed economies. Despite high debt levels, the central bank continues with monetary easing to stimulate consumption. To stimulate growth, the Chinese government is introducing tax cuts and reduction to company fees to businesses worth $300 billion USD. The tax cuts are aimed at transportation, construction and manufacturing sectors. A temporary truce was reached by China and the US in December 2018 that prevented further escalation of trade tariffs. The two countries imposed $300 billion worth of tariffs on each other's goods last year. The developments of ongoing trade talks are being closely monitored by the financial markets.



Graph 1



Graph 2

United States Overview

The US GDP is forecasted to grow at 2.3% this year with inflation coming in at 1.7%. The unemployment rate is expected to come in at 3.7%. Low unemployment rates and improving wages have not caused inflation to rise. The US inflation rate has fallen short of the central bank's 2% target.

The Federal Reserve ("Fed") raised rates four times last year due to a strong labour market and growth in the economy. The Fed indicated in December that two rate hikes are possible in 2019. In March 2019, the Fed held the rate steady and cited the slowdown in the global economy along with consumer and business spending as reasons for holding interest rates at the current level.

The trade talks between the US and China have been mainly positive although no agreement has been made on the contentious issues tied to protection of intellectual properties, removal of tariffs and enforcement issues. President Trump has threatened to impose a 25% tariff on all imports from China if the two sides cannot resolve the trade dispute. The IMF estimated that if a 25% tariff is applied on all trade between the world's two largest economies, it will reduce US GDP by 0.6% and China's GDP by 1.5%.

Canadian Overview

Canada's GDP is forecasted to grow 1.5% with inflation reaching 1.7%. The unemployment rate in February came in at 5.8% with 58,000 jobs created, average wages grew by 2.2% year over year in February.

Despite strong job creation, the Bank of Canada ("BOC") held rates steady in March as inflation rates fell short of target. The central bank cites global economic slowdown, softness in the domestic housing market and weak consumer spending as key risks to the economy. The Canadian dollar is trading around 75 cents against the US dollar, but the analysts are predicting the Loonie could fall to 71 cents due to sluggish commodity prices and interest rate expectations.

Governor Poloz tried to calm market concerns that Canada is heading towards recession stating investors have remained invested in the stock market and corporate debt. The BOC governor sees Canada's economic slowdown as temporary and points to growth in number of employed people, growth in wages and the exports sector as positive developments.

The United States-Mexico-Canada Agreement ("USMCA") trade agreement has not been ratified by the legislative bodies in countries in the trilateral deal. The steel and aluminum tariffs have remained, tariffs will be a drag on exports as US is our major export market. The export, film and tourism industry however will be aided by the low Canadian dollar.

British Columbia Overview

British Columbia's ("BC") economy is forecasted to grow by 1.8% with the unemployment rate expected to remain at 4.7% this year. The provincial government's tax policies, rising interest rates and federal mortgage stress test have slowed down the housing sector.

The slowdown in the housing sector will hold back spending on housing related goods and impact the construction, retail and financial sectors. Increased interest rates and mortgage stress test decreased purchasing power. The lack of affordability in BC further curtailed housing demand.

To address housing affordability issues, the Federal government announced measures aimed at first time home buyers. The Canadian Mortgage and Housing Corporation will finance 5% to 10% of home purchase through a shared equity mortgage program which will be income tested. There is a ceiling placed on the maximum price of the home. More details on this housing initiative is expected this fall.

Consumer spending's contribution to the economy is expected to diminish as highly indebted households adjust to higher interest rates. The BOC's decision to hold off on interest rates increase will provide some relief.

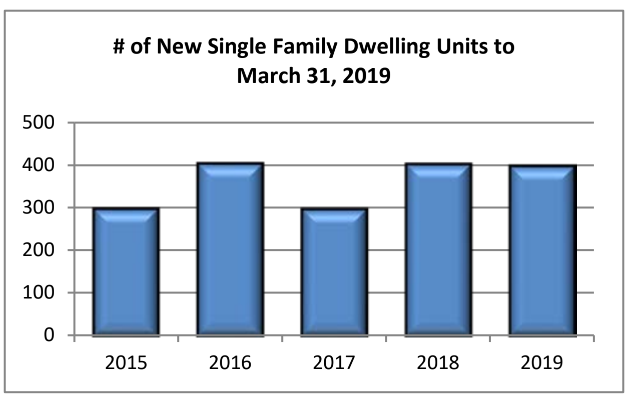
BC 2019 Budget Highlights

BC's Finance Minister delivered the Province's 2019 budget on February 19, 2019. It is a "stay-the-course" budget that targets overall affordability and the housing situation in BC. Some of the affordability measures include elimination of Medical Services Plan ("MSP") premiums by 50% in 2019 and by 100% in 2020; introduction of BC child opportunity benefit for families with children; eliminating interest on BC student loans; and raising income and disability assistance rates etc. Some of the housing affordability measures include building new affordable homes and limiting rent increases to the rate of inflation.

Surrey's Financial Performance

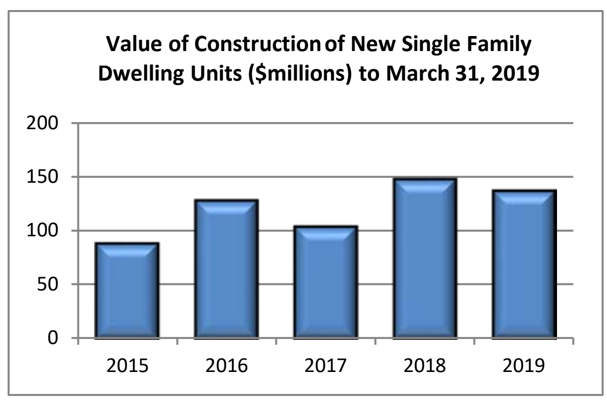
Overall the residential sector in the City is indicative of a cooling market conditions with sales of units year over year notably lower, and also as indicated by lower year over year planning application fees and building permit fees. The commercial and institutional sectors have not yet seen this cooling trend and are more indicative of a stabilized market.

The following graphs show data for the first three months of 2019 compared to previous years.



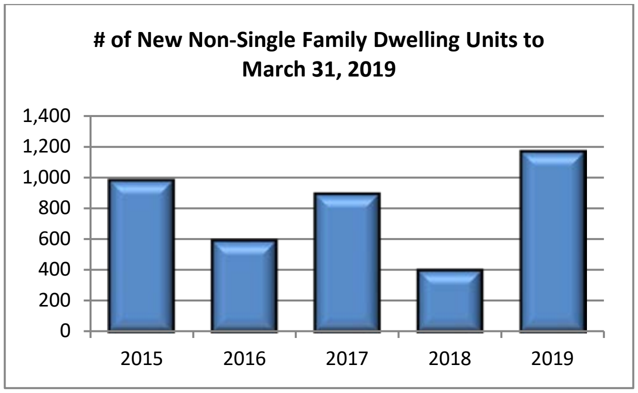
Graph 3

Similar to the trend for Single Family home sales in Metro Vancouver, mainly due to tougher Federal mortgage qualification rules, rising interest rates and BC budgetary changes, building activity in this dwelling type is flat year over year.



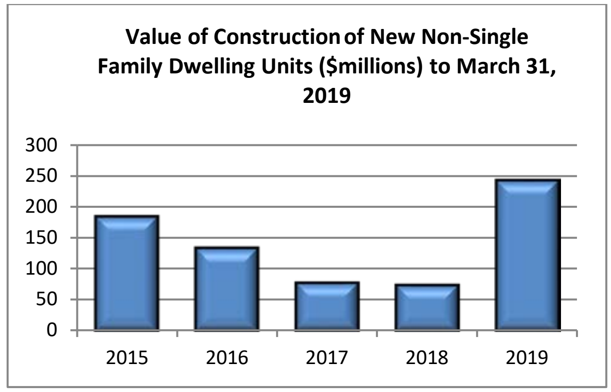
Graph 4

Consistent with the trends in the number of Single Family dwelling units being built in this quarter as compared to the same quarter last year, the value of construction has slightly decreased when compared to the same period last year.



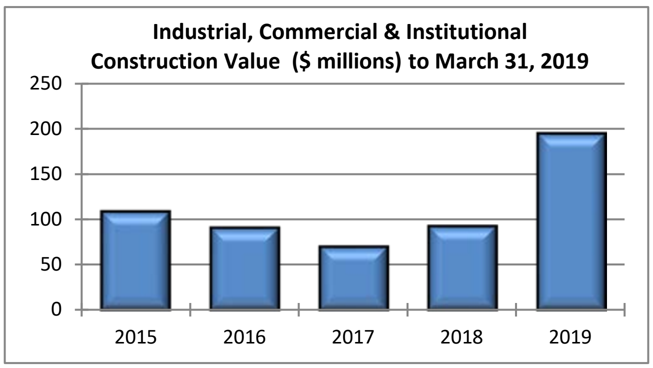
Graph 5

Due to three new significant multi-family high rise residential projects being given permits in this quarter, the total number of Non-Single Family dwelling units being built in this quarter is significantly higher than the same quarter last year. Quarter 1 figures are indicative of record high levels.



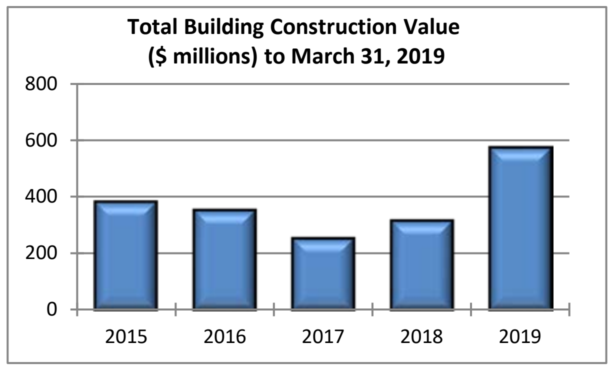
Graph 6

Consistent with the number of Non-Single Family dwelling units being built in this quarter as compared to the same quarter last year, the value of construction has increased significantly when compared to the same period last year.



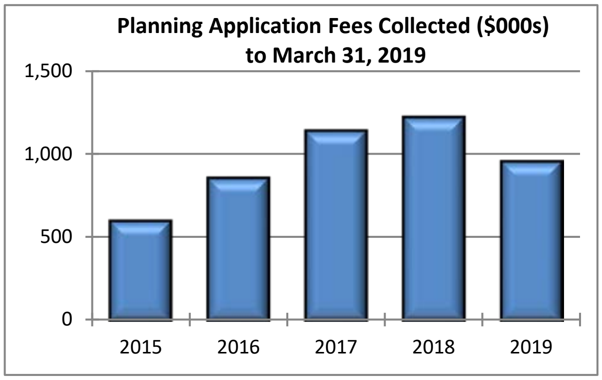
Graph 7

Construction value of Industrial, Commercial Institutional ("ICI") permits for the first quarter of 2019 is significantly higher as compared to the same period in 2018. This is primarily due to a large office building project in the Newton area and a few industrial building projects in the Campbell Heights area. Quarter 1 figures are indicative of record high levels.



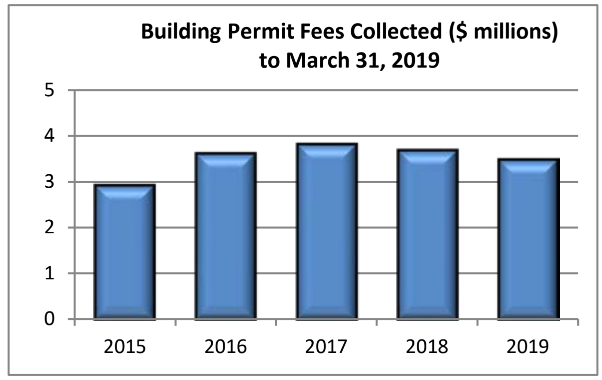
Graph 8

Overall, the value of total building construction in the City for the first three months of the year is significantly higher when compared to the same period last year, due to the increased construction activity in overall ICI sector and the three new significant multi-family high rise residential projects discussed earlier. Quarter 1 figures are indicative of record high levels.



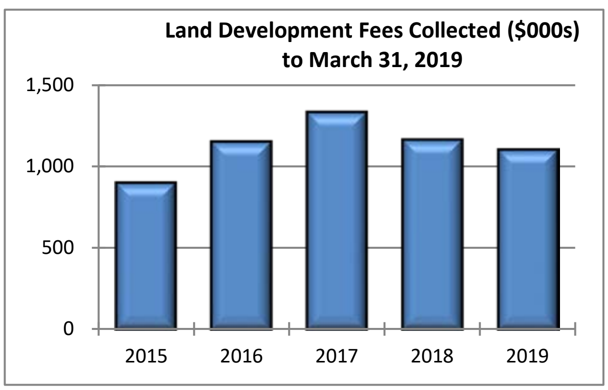
Graph 9

Planning application fees collected in the first quarter of the year are 22% lower than those collected in the same period last year. Declining real estate sales likely had an impact on applications being received by the City for new build projects.



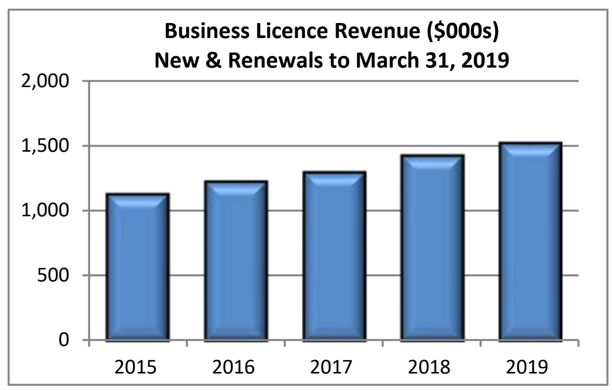
Graph 10

Building permit fees collected for the first three months of this year are 5% lower than those collected in the same period last year. These fees are indicative of Building Permits issued by the City for new build projects. The decline in the collection from these fees is consistent with a decline in planning application fees.



Graph 11

Similar to a decline in Building Permit fees collected in this quarter, Engineering Land Development fees collected in the first three months of the year are 5% lower than the same period in 2018.

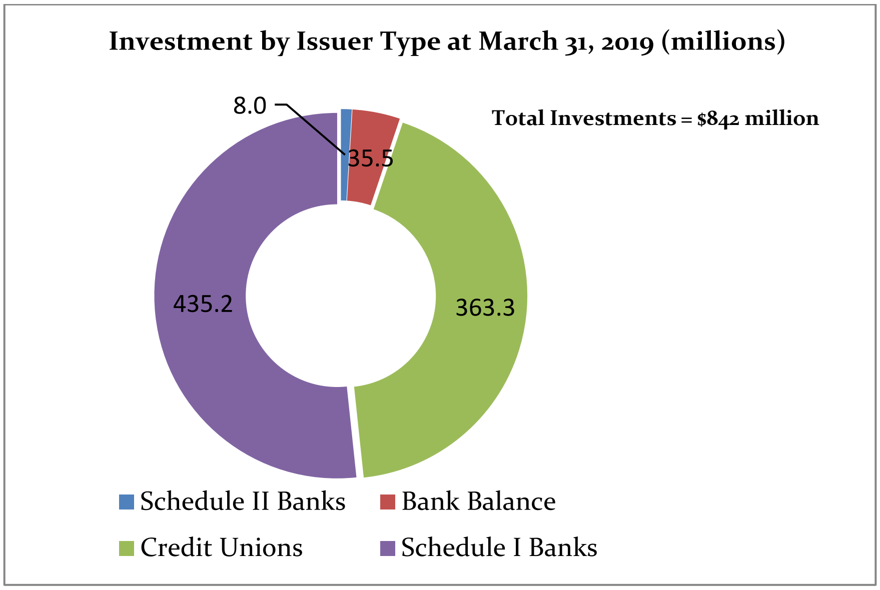


Graph 12

Business Licence Revenue has increased by 7% as compared to the same period last year due to an increase in business activity in the City.

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 $842 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. The graph below shows the City's Investment Portfolio by issuer type.



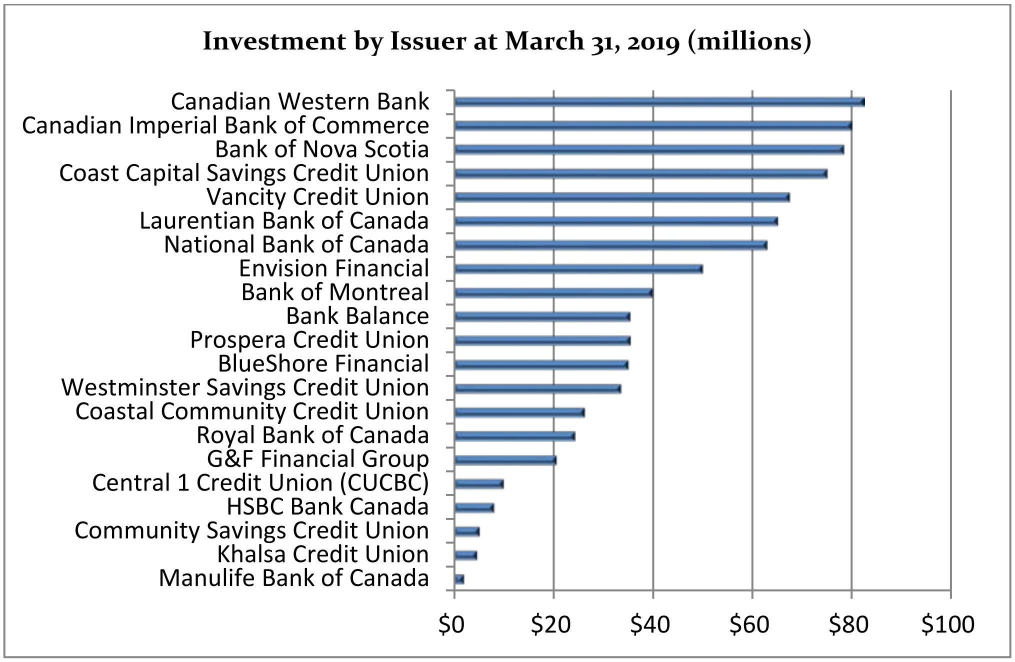
Graph 13

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

Objectives of the Policy include:

Diversification

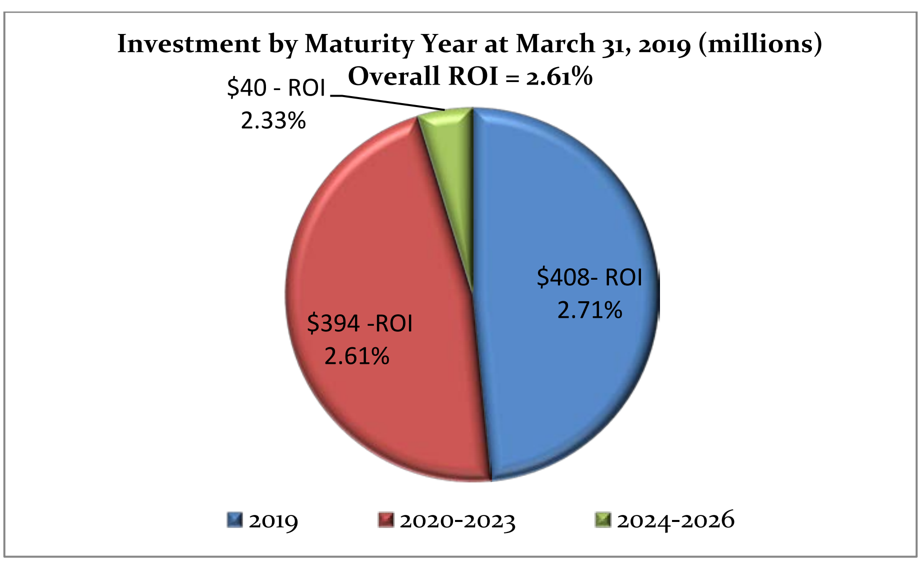
In order to reduce overall portfolio risk, the City diversifies its investment holdings across a range of security types and financial institutions. Graph 14 shows a listing of the City's portfolio by Financial Institution.



Graph 14

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. Graph 15 shows the portfolio by maturity terms.



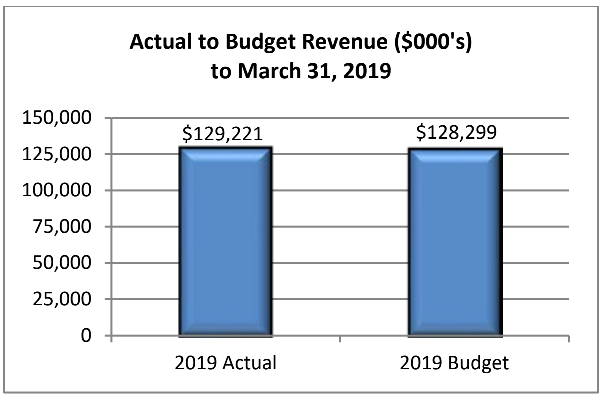
Graph 15

Return on Investment

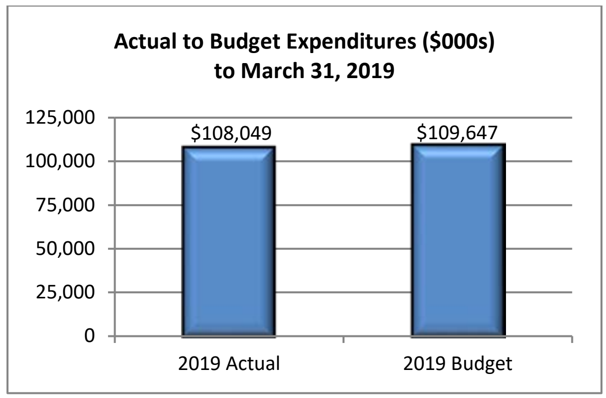
The City's investment portfolio is currently earning a combined rate of approximately 2.61% while maintaining investment security as outlined in the City's investment policy. Interest revenue is currently expected to meet budget by year end. The City strives to earn a reasonable rate of return on the investment portfolio throughout varying budgetary and economic cycles, taking into account investment risk constraints and liquidity needs.

Actual Revenues and Expenditures Relative to the 2018 Budget (Financial Plan)

The following graphs illustrate the variances between the actual and the budgeted operating revenues and expenditures respectively, excluding transfers to reserves, for the first quarter of 2019.



Graph 16



Graph 17

Appendix "I" documents the General Operating Fund's revenues and expenditures for the first quarter of 2019 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 2019 Financial Plan; and as shown in Appendix "II".

Policing Transition has a favourable variance of $110,000, resulting from the timing of expenditures.

RCMP Contract currently has a favourable variance of $302,000, resulting from vacancies and timing of expenditures.

Fire Department has a favourable variance of $179,000, resulting from higher than budgeted revenues and the timing of expenditures.

Engineering Department currently has a favourable variance of $352,000, primarily due to the timing of revenue recognition, staff vacancies and the timing of expenditures.

Parks, Recreation & Culture Department is showing a small favourable departmental variance of $35,000, which is primarily due to the timing of various expenditures.

Surrey Public Library currently has a favorable variance of $96,000, primarily due to the timing of expenditures relative to budget.

Planning & Development Department, which also includes Civic Facilities, is reporting a positive variance of $522,000 due to the revenues recognized being higher than budget, staff vacancies and the timing of maintenance costs for civic facilities.

Mayor and Council has a favourable variance of $48,000, resulting from timing of expenditures.

City Grants is currently on budget.

City Manager's Department has a small favourable variance of $8,000.

Investment & Intergovernmental Relations Department currently has a favourable variance of $112,000, primarily due to the timing of expenditures.

Finance Department currently has a favourable variance of $31,000, primarily due to staff vacancies.

Corporate Services Department has a favourable variance of $374,000 due to staff vacancies and timing of expenditures.

CONCLUSION

Overall, in relation to the 2019 adopted budget, there have been no material concerns noted for the first quarter of 2019. Staff will continue to closely monitor all areas to ensure that any variances from the 2019-2023 adopted budget are recognized in a timely fashion and appropriate mitigating action is taken.

Kam Grewal, CPA, CMA
General Manager, Finance

Appendix "I": 2019 First Quarter Council Report, Executive Summary - Revenues & Expenditures
Appendix "II": 2019 First Quarter Council Report, Departmental Detail

Appendix “I”

2019 1st QUARTER COUNCIL REPORT

EXECUTIVE SUMMARY - REVENUES & EXPENDITURES

$ 000's

REVENUE SUMMARY	2018: 1st Qtr YTD ACTUAL	2019: 1st Qtr YTD Actual	2019 YTD BUDGET	2019 ANNUAL BUDGET
Net Taxation	87,598	90,968	91,120	364,480
Investment Interest	3,825	4,179	4,161	17,623
Secondary Suite Infrastructure Fee	4,646	4,929	4,833	19,333
Contribution from SCDC	1,125	1,125	1,125	4,500
Provincial Casino Revenue Sharing	1,125	1,050	1,050	4,200
Penalties & Interest on Taxes	54	44	42	3,640
Corporate Leases	2,203	2,271	2,125	7,571
Carbon Tax Rebate	125	163	162	650
Other Revenues	575	960	949	4,525
Non-Tax Revenues	13,678	14,721	14,447	62,042
Program Revenues	22,367	23,533	22,731	87,805
TOTAL REVENUES	123,643	129,221	128,299	514,327

EXPENDITURE SUMMARY	2018: 1st Qtr YTD ACTUAL	2019: 1st Qtr YTD Actual	2019 YTD BUDGET	2019 ANNUAL BUDGET
Program Expenditures	104,926	105,733	107,102	461,630
Council Priorities	46	27	65	260
Fiscal Services	164	118	141	564
MFA Principal	3,194	2,008	2,008	12,779
Other	171	162	332	1,326
TOTAL EXPENDITURES	108,501	108,049	109,647	476,559

TRANSFER SUMMARY	2018: 1st Qtr YTD ACTUAL	2019: 1st Qtr YTD Actual	2019 YTD BUDGET	2019 ANNUAL BUDGET
Carbon Emission Offsets	125	163	163	650
Transfer to Capital Program	4,700	5,275	5,275	21,100
Contributions to Road & Trans. Fund	4,148	4,148	4,148	16,592
Transfers To(From) Own Sources	(408)	(117)	(326)	(574)
TOTAL TRANSFERS	8,565	9,468	9,259	37,768

Appendix "II"

2019 1st QUARTER COUNCIL REPORT
DEPARTMENTAL DETAIL
$ 000's

PROGRAM REVENUES	2018: 1st Qtr YTD ACTUAL	2019: 1st Qtr YTD ACTUAL	2019 YTD BUDGET	2019 ANNUAL BUDGET
Policing Transitioning	2,038	2,072	2,034	8,135
RCMP Contract	-	-	-	-
Fire	89	108	51	2,095
Engineering Services	2,139	2,308	2,131	7,830
Parks, Recreation & Culture	9,456	9,842	9,658	35,046
Surrey Public Library	417	451	403	1,595
Planning & Development	5,584	5,895	5,575	22,298
Mayor & Council	-	-	-	-
City Grants	-	-	-	-
City Manager			1	2
Invest. & Intergovernmental Relations	-	10	-	-
Finance	270	201	357	1,429
Corporate Services	2,374	2,645	2,521	9,375
TOTAL PROGRAM REVENUES	**22,367**	**23,533**	**22,731**	**87,805**

PROGRAM EXPENDITURES NET OF INTERNAL TRANSFERS	2018: 1st Qtr YTD ACTUAL	2019: 1st Qtr YTD ACTUAL	2019 YTD BUDGET	2019 ANNUAL BUDGET
Policing Transitioning	7,052	7,379	7,451	32,484
RCMP Contract	33,248	34,404	34,707	138,827
Fire	14,223	14,637	14,759	67,316
Engineering Services	2,238	2,339	2,514	10,291
Parks, Recreation & Culture	22,205	20,786	20,637	99,564
Surrey Public Library	4,459	4,602	4,650	18,777
Planning & Development	7,180	7,345	7,546	31,985
Mayor & Council	389	338	386	1,737
City Grants	439	440	440	1,758
City Manager	287	296	305	1,295
Invest. & Intergovernmental Relations	305	273	375	1,598
Finance	2,391	2,380	2,567	11,028
Corporate Services	10,509	10,515	10,766	44,970
TOTAL PROGRAM EXPENDITURES	**104,926**	**105,733**	**107,102**	**461,630**

NET PROGRAM	2018: 1st Qtr YTD ACTUAL	2019: 1st Qtr YTD ACTUAL	2019 YTD BUDGET	2019 ANNUAL BUDGET
Policing Transitioning	5,013	5,307	5,417	24,349
RCMP Contract	33,248	34,404	34,707	138,827
Fire	14,134	14,529	14,708	65,221
Engineering Services	100	31	383	2,461
Parks, Recreation & Culture	12,749	10,943	10,978	64,518
Surrey Public Library	4,041	4,150	4,247	17,182
Planning & Development	1,596	1,449	1,971	9,687
Mayor & Council	389	338	386	1,737
City Grants	439	440	440	1,758
City Manager	287	296	304	1,293
Invest. & Intergovernmental Relations	305	263	375	1,598
Finance	2,122	2,179	2,210	9,599
Corporate Services	8,135	7,870	8,244	35,595
NET PROGRAM TOTAL	**82,559**	**82,201**	**84,370**	**373,825**