CITY OF SURREY
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CORPORATE REPORT

NO: R159 COUNCIL DATE: July 22, 2019

REGULAR COUNCIL

TO:	**Mayor & Council**	DATE:	**July 11, 2019**
FROM:	**General Manager, Finance**	FILE:	**1880-20**
SUBJECT:	**Quarterly Financial Report - Second 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 six months 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, followed by an outline of Surrey's financial performance for the first two quarters of 2019. It also includes an overview of the City's investment portfolio performance.

Economic Environment and Key Economic Factors

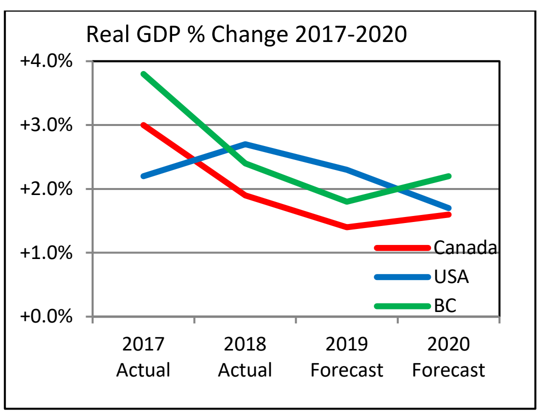
<u>International Overview</u>

The outlook for the global economy has deteriorated as geopolitical risks and trade protectionism continues to be a drag on demand and business investment. The International Monetary Fund ("IMF") downgraded global growth to 3.3% from its January 2019 forecast of 3.5%. Major headwinds facing the global economy include the United Kingdom's ("UK") disorderly departure from the European Union ("EU") and the escalation of trade disputes between the United States ("US") and its major trading partners, mainly China.

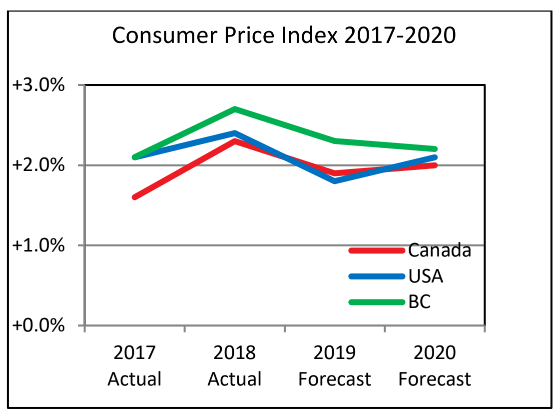
The Eurozone economy is showing signs of further slowing in the second quarter with retails sales falling. Trade conflict between the US and China has weighed on demand in the manufacturing and export sectors. The European Central Bank ("ECB") announced that it is prepared to provide monetary easing through interest rate cuts or further asset purchases if inflation does not reach its target level. Analysts are expecting the ECB to cut interest rates before the end of this September. Further monetary easing will devalue the Euro, which may lead President Trump to act on his threat of imposing tariffs on auto imports from Europe. Any US tariffs on European cars would hit Germany's auto industry particularly hard.

After multiple failed bids to ratify the negotiated Brexit bill in parliament, Theresa May quit as leader of the Conservative Party in June and will step down as the UK's Prime Minister in July. The Conservative Party leadership race is set to conclude in late July. Regardless of who is selected as the UK's next Prime Minister, Eurozone leaders are adamant that the Brexit deal will not be renegotiated. The EU indicated that no further extension beyond the October 31, 2019 deadline will be granted unless the UK is prepared to call a second Brexit referendum or a general election. If the UK exits the EU without a negotiated deal, it would trade with the EU on World Trade Organization ("WTO") rules. Under WTO conventions, the movement of goods would be subject to tariffs and checks at European borders. The Bank of England's governor has indicated that the central bank is prepared to provide monetary stimulus to support the UK's economy in the event of a "no-deal" Brexit.

China's Gross Domestic Product ("GDP") is forecasted to come in at 6.2% this year. The IMF continues to urge the Chinese government to make further structural changes to reform state-owned enterprises and continue with opening its market to the rest of the world. The trade dispute with the US has slowed down the Chinese economy and interrupted supply chains. Contentious issues include US demands for protection of intellectual property and the provision of an enforcement mechanism should either party violate the trade agreement. China wants existing tariffs on Chinese goods to be removed while trade talks continue, while the US is determined to keep them in place. Trade talks between the US and China are set to resume soon, no deadline for the negotiations has been imposed.



Graph 1



Graph 2

United States Overview

US GDP is forecasted to come in at 2.3% this year. The unemployment rate remained at a 50-year low of 3.6% in May with hourly wages rising 3.1% year over year. The Federal Reserve ("Fed") left its key interest rate unchanged at its June meeting but signalled a willingness towards rate cuts to support the economy if required. The Fed Chair indicated that if a rate cut does occur this year, it will be a pre-emptive move to address uncertainties over trade policies and would not exceed 25 basis points. The Fed will continue to monitor the impact of trade uncertainties on economic growth.

Trade talks between the US and China reached an impasse in May after the US accused the Chinese side of backing away from items that were previously settled through negotiations. In May, President Trump increased tariffs on $200 billion of Chinese goods from 10% to 25%. He also threatened to levy the same 25% tariff on an additional $300 billion of Chinese exports. In addition to tariffs, the US also placed a large number of Chinese companies on their "Entity List" which restricts US companies from conducting business with blacklisted foreign firms without prior approval from the federal government. Companies such as Google, Intel and Qualcomm halted shipments to China.

Business leaders in the US are calling for the de-escalation of the year-long trade war with China as tariffs increase costs to businesses, which in turn, get passed down to consumers through higher prices. Due to ongoing trade policy uncertainties, businesses are holding off on further hiring and investments.

Investors' concerns with escalating trade tensions were somewhat eased with President Trump and President Xi agreeing to a temporary truce during the G20 summit in June. China agreed to purchase more products from the US. In exchange, the US has agreed to allow US firms to sell parts and components to China's leading technology firm, Huawei.

Canadian Overview

Canada's economy is forecasted to grow at a rate of 1.4% this year. The unemployment rate dropped to 5.4% in May, the lowest in over 40 years. The labour market continues to strengthen with over 134,000 jobs added to the economy in April and May. Canada's inflation rate rose to 2.4% in May compared to the prior year with price increase across most categories of goods. The recent hiring spree and inflation results suggest that the slowdown experienced over the last two quarters was temporary and the economy is on the upswing.

The Bank of Canada's ("BOC") governor continues to reiterate that future interest rate movements will be data dependent. The central bank will continue to monitor household spending, oil markets and developments in global trade. The Canadian dollar appreciated against the US dollar in June after the US Fed signalled a willingness to cut interest rates in the future if economic conditions worsen.

Interest rates in Canada and the US tend to move in tandem, however, there have been occasions in the past where the two countries have diverged. If Canadian interest rates were significantly higher than US rates, increased capital inflow to Canada would boost the Loonie's value and hamper exports and tourism. Given strong employment numbers and inflation being on target, the BOC is unlikely to follow the Fed down the path of rate cuts, should the scenario materialize.

The US lifted its tariffs against Canadian and Mexican steel and aluminum in May. The tariffs had been a barrier to Canada and Mexico ratifying the Canada-Unites States-Mexico Agreement ("CUSMA"). Mexico became the first country to ratify the agreement in June. Legislation was introduced to the Canadian parliament to begin the process of ratification. The House of Commons will be adjourned for two months. Prime Minister Trudeau has indicated that he will recall lawmakers to pass the trade deal if the US manages to have CUSMA approved by its own legislative bodies in the next month.

British Columbia Overview

British Columbia's ("BC") GDP is expected to come in at 1.8% this year. BC's unemployment rate was 4.3% in May with 16,000 jobs created. BC's tourism, export and film sectors are projected to experience continued growth. The province's resource sectors will further contribute to the economy with the construction of a Liquefied Natural Gas ("LNG") plant in Kitimat and the Trans Mountain pipeline expansion, which is expected to start this year.

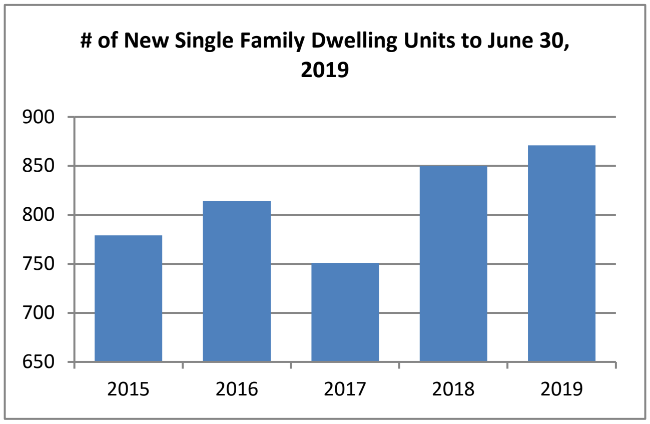
Housing sales have slowed down since various tax policies targeting real estate were introduced. Rising interest rates and the federal mortgage stress test have also contributed to dampened demand. Home sales were below the historic average in June. The benchmark price for a detached home fell 10.9% year-over-year in June and apartment prices fell 8.9% during the same period. Although home prices have fallen, they are still not considered affordable. The benchmark price for all types of homes was $998,700 in June.

The first instalment of the BC Employer Health Tax ("EHT") came due in June of this year. Businesses will pay both EHT and Medical Service Plan ("MSP") premiums during 2019 while the MSP phase out takes place. A survey by the BC Chamber of Commerce shows that respondents are experiencing increased costs of doing business. To keep up with increased cost pressures, BC businesses are raising prices, cutting back on staffing levels and delaying business investments. Many of the businesses surveyed list affordable housing for employees and workforce retention as key concerns.

Surrey's Financial Performance

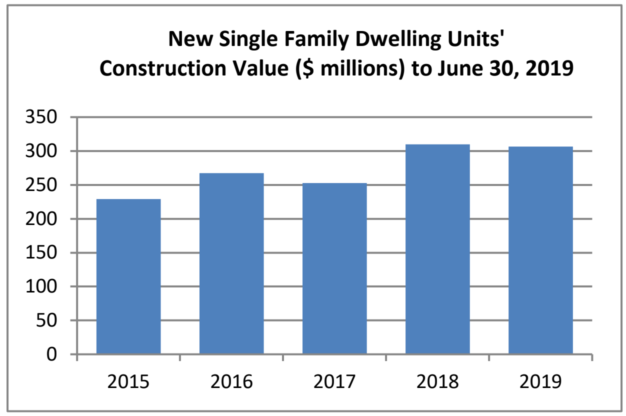
Overall, single family residential sector in the City is indicative of cooling market conditions with sales of units year over year notably lower, and also as indicated by a shift towards increased construction activity in non-single family properties. The industrial, commercial and institutional sectors have not yet seen this cooling trend and are more indicative of a stabilized market.

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



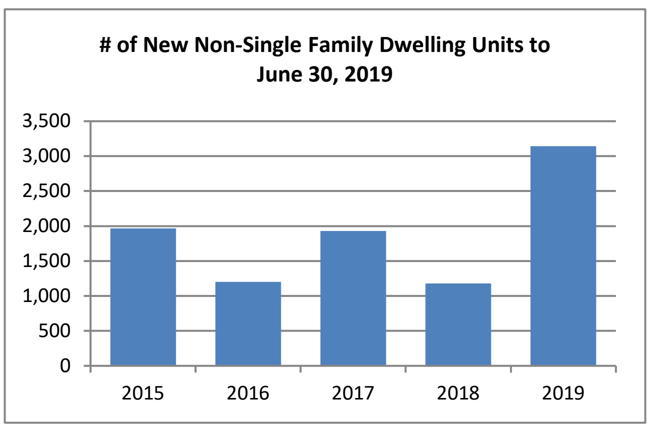
Graph 3

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. The slight increase in dwelling units can be attributed to more single-family homes being built with secondary suites, resulting in more dwelling units.



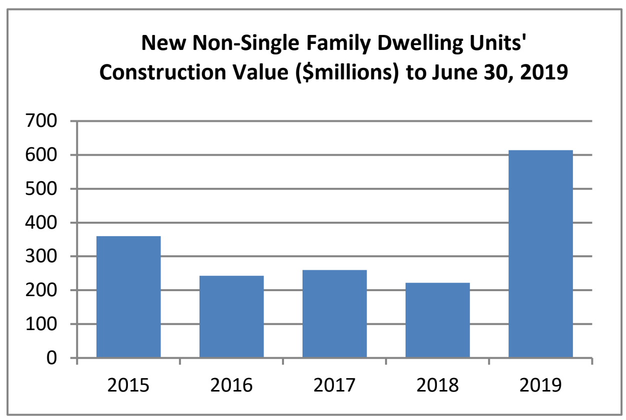
Graph 4

Consistent with the trends in the number of Single Family dwelling units being built in this six month period as compared to the same period last year, the value of construction is also flat when compared to the same period last year.



Graph 5

Due to an increase in new townhouse and new low rise apartment projects being given permits in this six month period, the total number of Non-Single Family dwelling units being built in this period is significantly higher than the same period last year. Some of the significant townhouse projects are being constructed in East Clayton, Grandview Heights, Fleetwood and Newton. Some of the significant low rise apartments are being constructed in the City Centre area.

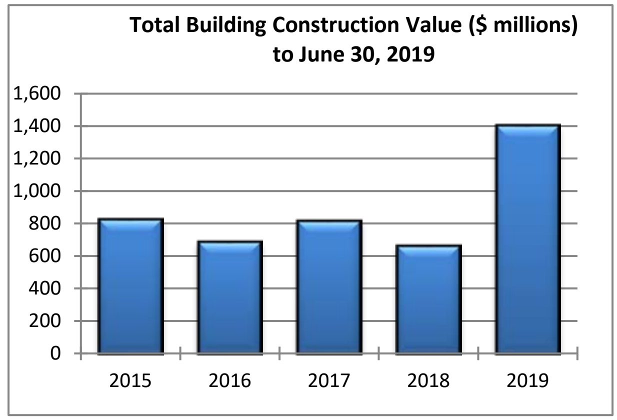


Graph 6

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

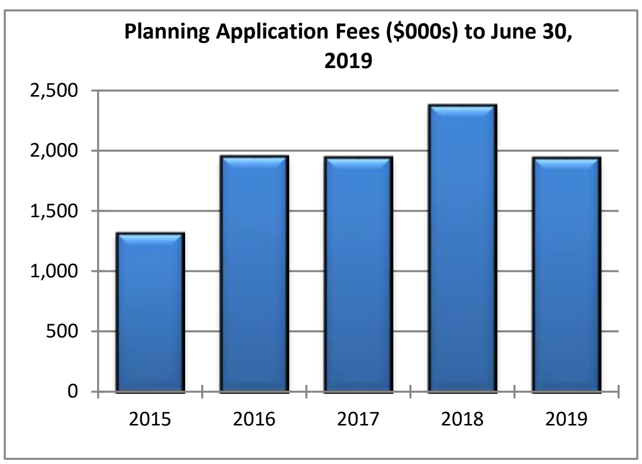
Graph 7

Construction value of Industrial, Commercial Institutional ("ICI") permits during this period is significantly higher as compared to the same period in 2018. This is primarily due to a few large retail and warehouse businesses; and a new secondary and two new elementary schools being issued their permits in this period.



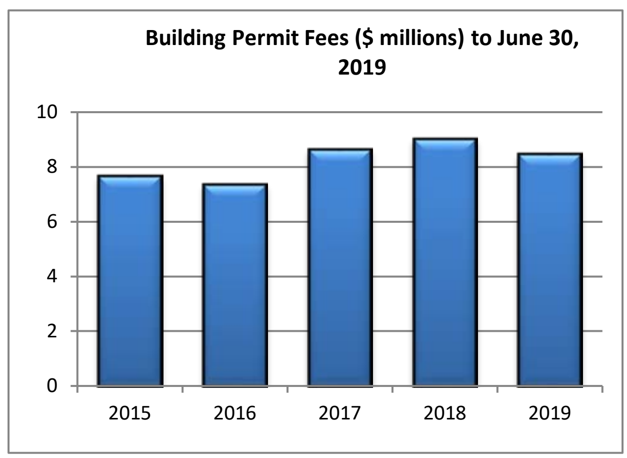
Graph 8

Overall, the value of total building construction in the City for the first six months of the year is significantly higher when compared to the same period last year, due to the increased construction activity in the ICI sector and the Non-Single Family building construction.



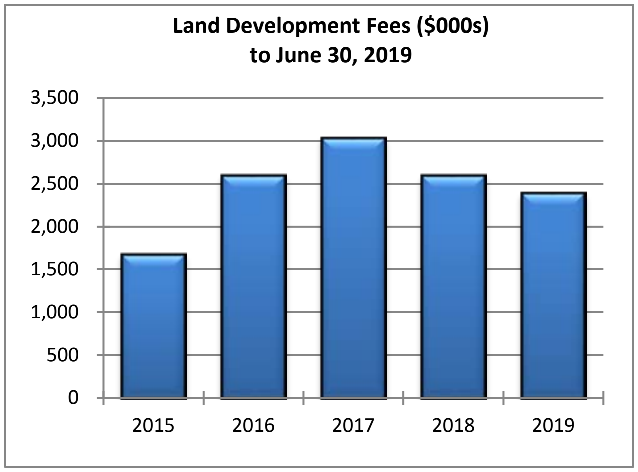
Graph 9

Planning application fees collected in the first six months of the year are 18% 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.



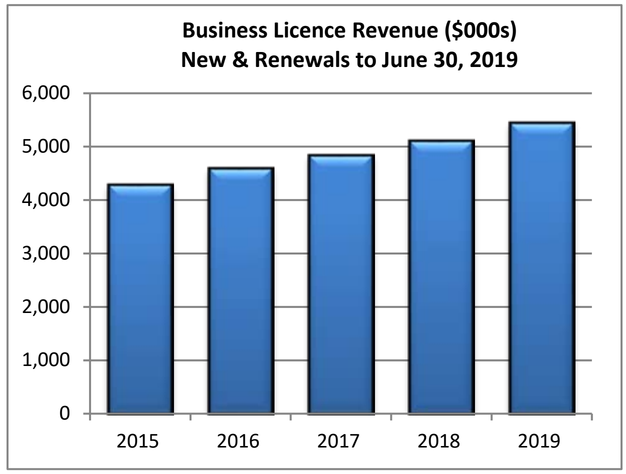
Graph 10

Building permit fees collected for the first six months of this year are 6% 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 period, Engineering Land Development fees collected in the first six months of the year are 5% lower than the same period in 2018.

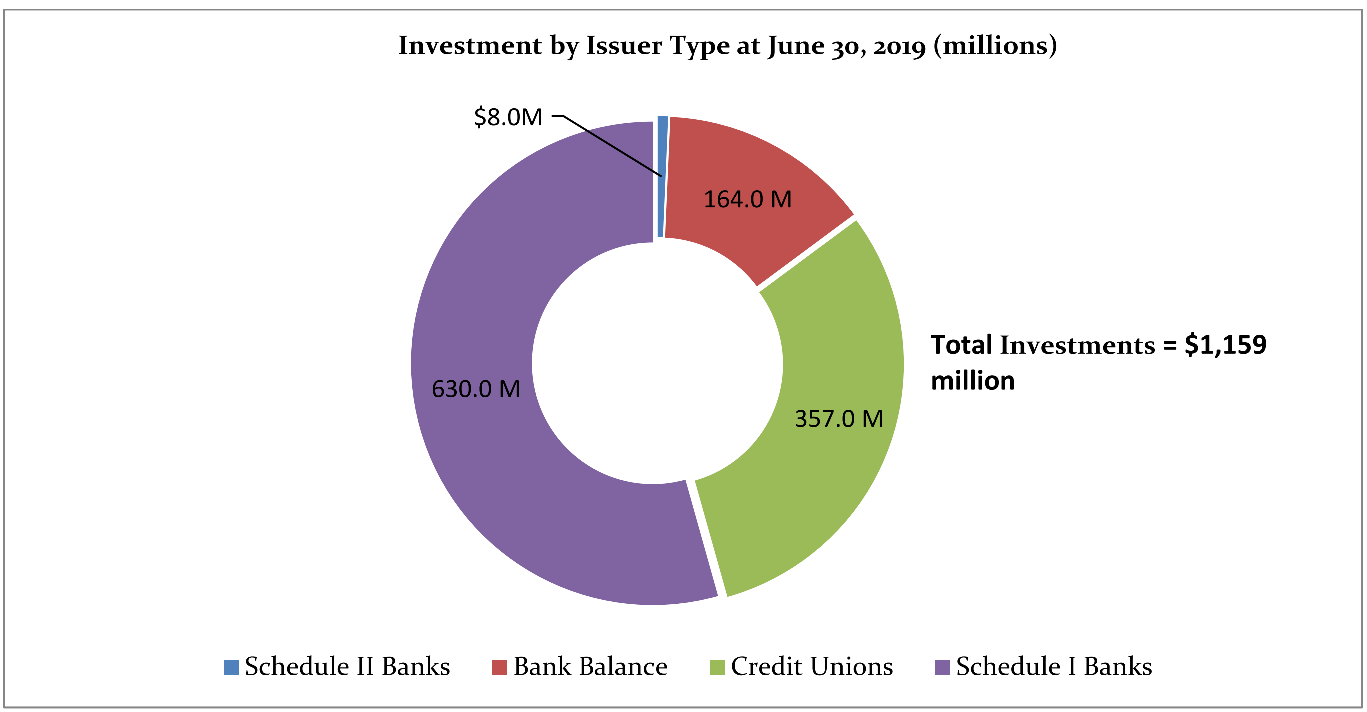


Graph 12

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 $1,159 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.



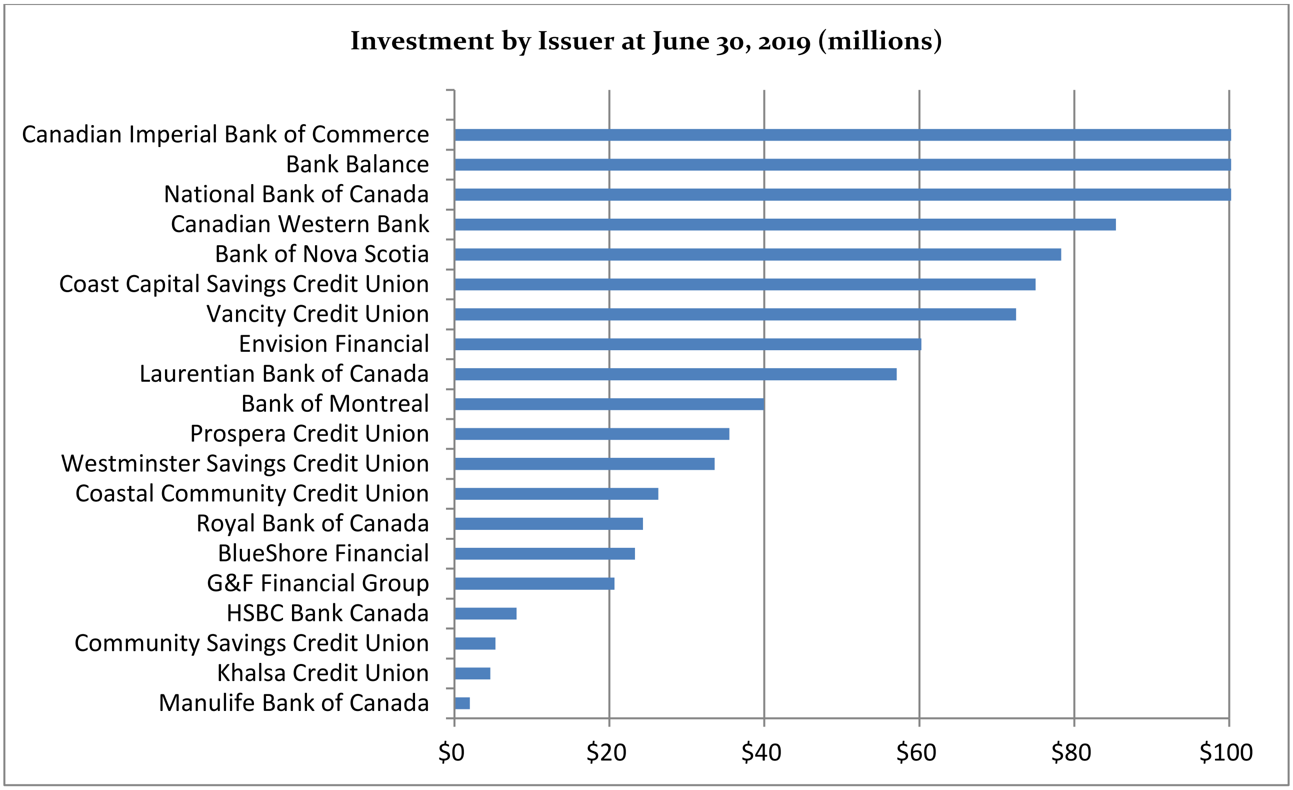
Graph 13

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

Objectives of the Policy include:

Diversification

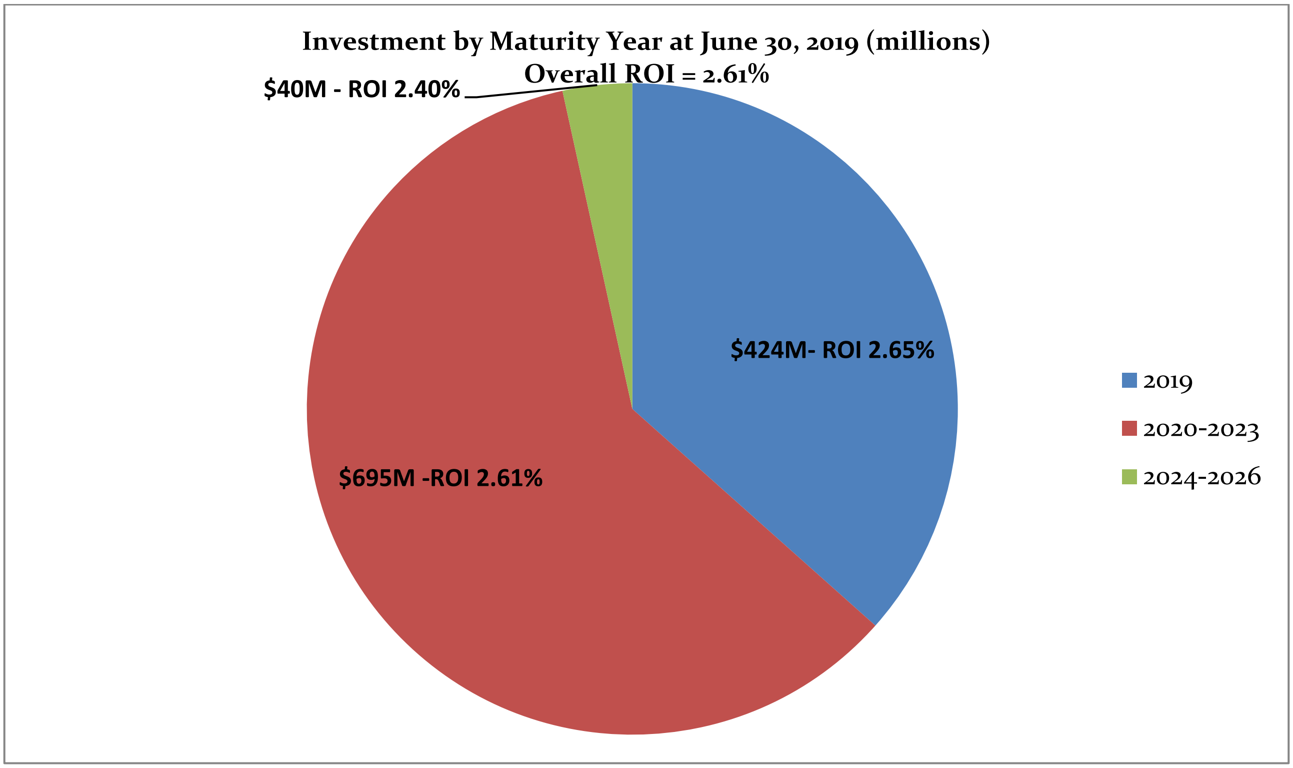
In order to reduce overall portfolio risk, the City diversifies its investment holdings across a range of security types and financial institutions. Graph 14 shows a listing of the City's portfolio by Financial Institution.



Graph 14

<u>Liquidity</u>

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.



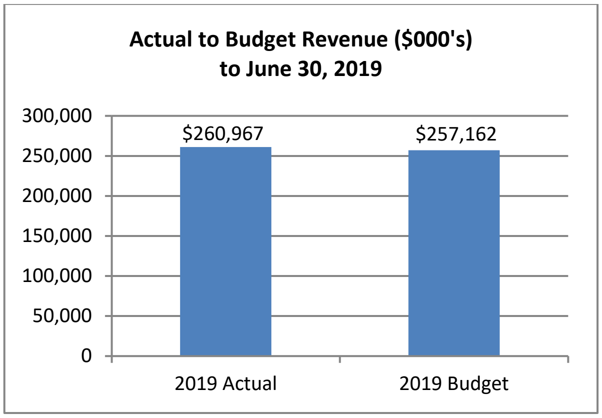
Graph 15

<u>Return on Investment</u>

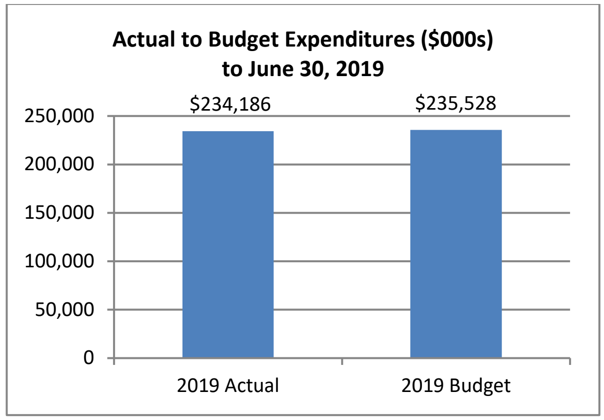
The City's investment portfolio is currently earning a combined rate of approximately 2.61% while maintaining investment security as outlined in the City's investment policy. Interest revenue is currently expected to meet budget by year end. The City strives to earn a reasonable rate of return on the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

Actual Revenues and Expenditures Relative to the 2019 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 second quarter of 2019.



Graph 16



Graph 17

Appendix “I” documents the General Operating Fund’s revenues and expenditures for the second 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 Department has a favourable variance of $251,000, resulting from higher than budgeted revenues. It is forecasted that Policing Transition will have a favourable variance of $306,000 at year-end.

RCMP Contract currently has a favourable variance of $197,000, resulting from vacancies and timing of expenditures. It is forecasted that RCMP Contract will have a favourable variance of $197,000 at year-end.

Fire Department has a favourable variance of $214,000, resulting from higher than budgeted revenues and the timing of expenditures. It is forecasted that Fire Department will have a favourable variance of $42,000 at year-end.

Engineering Department currently has a favourable variance of $548,000, primarily due to the timing of revenue recognition. It is forecasted that Engineering Department will have a favourable variance of $641,000 at year-end.

Parks, Recreation & Culture Department is showing a small favourable departmental variance of $484,000, which is primarily due to the timing of various expenditures. It is forecasted that Parks, Recreation & Culture Department will have a favourable variance of $33,000 at year-end.

Surrey Public Library currently has a favorable variance of $267,000, primarily due to the timing of expenditures relative to budget. Surrey Public Library is forecasted to meet budget by year-end.

Planning & Development Department which also includes Civic Facilities, is reporting a positive variance of $1,481,000 due to the revenues recognized being higher than budget, staff vacancies and the timing of maintenance costs for civic facilities. It is forecasted that Planning & Development Department will have a favourable variance of $1,352,000 at year-end.

Mayor and Council Department has a favourable variance of $49,000, resulting from timing of expenditures and is forecasted to meet budget by year-end.

City Grants has a favourable variance of $134,000, resulting from timing of the grants and is forecasted to meet budget by year-end.

City Manager's Department has a favourable variance of $61,000 due to vacancies and timing of expenditures. It is forecasted that City Manager's Department will have a favourable variance of $133,000 at year- end.

Investment & Intergovernmental Relations Department currently has a favourable variance of $183,000, primarily due to the timing of expenditures. It is forecasted that Investment & Intergovernmental Relations Department will have a favourable variance of $206,000 at year-end.

Finance Department currently has a favourable variance of $243,000, primarily due to staff vacancies. It is forecasted that Finance Department will have a favourable variance of $243,000 at year- end.

Corporate Services Department has a favourable variance of $525,000 due to higher than budgeted revenues, staff vacancies and timing of expenditures. It is forecasted that Corporate Services Department will have a favourable variance of $309,000 at year- end.

CONCLUSION

Overall, in relation to the 2019 adopted budget, there have been no material concerns noted for the second 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 Second Quarter Council Report, Executive Summary - Revenues & Expenditures
Appendix "II": 2019 Second Quarter Council Report, Departmental Detail

Appendix “I”

2019 2nd QUARTER COUNCIL REPORT
EXECUTIVE SUMMARY - REVENUES & EXPENDITURES
$ 000's

REVENUE SUMMARY	2019: 2nd Qtr YTD Actual	2019 YTD BUDGET	2019: 2nd Qtr YTD Variance	2019 ANNUAL FORECAST	2019 ANNUAL BUDGET	2019 Projected Variance
Net Taxation	182,027	182,240	(213)	364,567	364,480	87
Investment Interest	8,830	8,216	614	18,126	17,623	503
Secondary Suite Infrastructure Fee	9,767	9,667	100	19,433	19,333	100
Contribution from SCDC	2,250	2,250	-	4,500	4,500	-
Provincial Casino Revenue Sharing	2,100	2,100	-	4,200	4,200	-
Penalties & Interest on Taxes	235	205	30	3,670	3,640	30
Corporate Leases	3,691	3,713	(22)	7,549	7,571	(22)
Carbon Tax Rebate	325	325		650	650	
Other Revenues	2,279	2,215	64	4,588	4,525	63
Non-Tax Revenues	29,477	28,690	786	62,717	62,042	675
Program Revenues	49,464	46,231	3,232	91,550	87,805	3,745
TOTAL REVENUES	260,967	257,162	3,806	518,834	514,327	4,507
EXPENDITURE SUMMARY	**2019: 2nd Qtr YTD Actual**	**2019 YTD BUDGET**	**2019: 2nd Qtr YTD Variance**	**2019 ANNUAL FORECAST**	**2019 ANNUAL BUDGET**	**2019 Projected Variance**
Program Expenditures	226,614	228,019	1,405	461,912	461,630	(283)
Council Priorities	130	130	()	260	260	()
Fiscal Services	344	282	(62)	626	564	(62)
MFA Principal	6,435	6,434	(1)	12,779	12,779	
Other	663	663	-	1,326	1,326	-
TOTAL EXPENDITURES	234,186	235,528	1,342	476,903	476,559	(344)
TRANSFER SUMMARY	**2019: 2nd Qtr YTD Actual**	**2019 YTD BUDGET**	**2019: 2nd Qtr YTD Variance**	**2019 ANNUAL FORECAST**	**2019 ANNUAL BUDGET**	**2019 Projected Variance**
Carbon Emission Offsets	325	325	()	650	650	()
Transfer to Capital Program	10,920	10,550	(370)	21,470	21,100	(370)
Contributions to Road & Trans. Fund	8,296	8,296		16,592	16,592	
Transfers To(From) Own Sources	(11)	(334)	(324)	931	(574)	(1,505)
TOTAL TRANSFERS	19,530	18,837	(694)	39,643	37,768	(1,875)
Surplus (Deficit)	7,251	2,798	4,454	2,288		2,288
Transfer (To)From Surplus	(7,251)	(2,798)	(4,454)	(2,288)	()	(2,288)
BALANCED BUDGET	-	-	-	-	-	-

PROJECTED SURPLUS (DEFICIT)	$ 2,288

Appendix "II"

2019 2nd QUARTER COUNCIL REPORT
DEPARTMENTAL DETAIL
$ 000's

PROGRAM REVENUES	2018: 2nd Qtr YTD ACTUAL	2019: 2nd Qtr YTD ACTUAL	2019 YTD BUDGET	2019: 2nd Qtr YTD Variance	2019 Projected ACTUAL	2019 ANNUAL BUDGET	2019 Projected Variance
Policing Transition	3,912	4,300	4,068	233	8,368	8,135	233
RCMP Contract	-	-	-	-	-	-	-
Fire	1,735	2,205	1,961	244	2,386	2,095	291
Engineering Services	4,198	4,717	4,029	688	8,315	7,830	485
Parks, Recreation & Culture	18,933	19,274	18,699	575	34,732	35,046	(314)
Surrey Public Library	854	920	804	116	1,670	1,595	75
Planning & Development	11,643	12,264	11,149	1,114	24,746	22,298	2,448
Mayor & Council	-	-	-	-	-	-	-
City Grants	-	-	-	-	-	-	-
City Manager			1	(1)	1	2	(1)
Invest. & Intergovernmental Relations	-	10	-	10	10	-	10
Finance	665	595	715	(119)	1,310	1,429	(119)
Corporate Services	5,018	5,180	4,807	373	10,012	9,375	637
TOTAL PROGRAM REVENUES	46,958	49,464	46,231	3,232	91,550	87,805	3,745

PROGRAM EXPENDITURES NET OF INTERNAL TRANSFERS	2018: 2nd Qtr YTD ACTUAL	2019: 2nd Qtr YTD ACTUAL	2019 YTD BUDGET	2019: 2nd Qtr YTD Variance	2019 Projected ACTUAL	2019 ANNUAL BUDGET	2019 Projected Variance
Policing Transition	15,303	16,062	16,080	19	32,411	32,484	74
RCMP Contract	66,498	69,216	69,413	197	138,630	138,827	197
Fire	31,084	32,738	32,708	(30)	67,564	67,316	(248)
Engineering Services	5,960	5,836	5,697	(140)	10,135	10,291	156
Parks, Recreation & Culture	45,337	47,064	46,973	(90)	99,217	99,564	347
Surrey Public Library	9,180	9,444	9,594	150	18,852	18,777	(75)
Planning & Development	14,794	15,587	15,954	367	33,081	31,985	(1,096)
Mayor & Council	792	779	828	49	1,737	1,737	()
City Grants	879	1,195	1,329	134	1,758	1,758	-
City Manager	591	585	647	62	1,161	1,295	134
Invest. & Intergovernmental Relations	639	626	799	173	1,401	1,598	197
Finance	4,988	5,133	5,495	362	10,666	11,028	362
Corporate Services	21,111	22,349	22,501	152	45,298	44,970	(328)
TOTAL PROGRAM EXPENDITURES	217,156	226,614	228,019	1,405	461,912	461,630	(283)

NET PROGRAM	2018: 2nd Qtr YTD ACTUAL	2019: 2nd Qtr YTD ACTUAL	2019 YTD BUDGET	2019: 2nd Qtr YTD Variance	2019 Projected ACTUAL	2019 ANNUAL BUDGET	2019 Projected Variance
Policing Transition	11,391	11,761	12,013	251	24,043	24,349	306
RCMP Contract	66,498	69,216	69,413	197	138,630	138,827	197
Fire	29,349	30,533	30,748	214	65,179	65,221	42
Engineering Services	1,763	1,120	1,667	548	1,820	2,461	641
Parks, Recreation & Culture	26,404	27,790	28,274	484	64,485	64,518	33
Surrey Public Library	8,326	8,524	8,790	267	17,182	17,182	-
Planning & Development	3,151	3,324	4,805	1,481	8,335	9,687	1,352
Mayor & Council	792	779	828	49	1,737	1,737	()
City Grants	879	1,195	1,329	134	1,758	1,758	-
City Manager	591	585	646	61	1,160	1,293	133
Invest. & Intergovernmental Relations	639	616	799	183	1,392	1,598	206
Finance	4,323	4,538	4,781	243	9,356	9,599	243
Corporate Services	16,093	17,169	17,694	525	35,286	35,595	309
NET PROGRAM TOTAL	170,198	177,150	181,787	4,637	370,362	373,825	3,463