

REGULAR COUNCIL

TO: **Mayor & Council**

DATE: **May 11, 2023**

FROM: **General Manager, Finance**

FILE: **1880-20**

SUBJECT: **Quarterly Financial Report - First 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 quarter of 2023 and to compare this activity with 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 quarter 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

International Overview

In March of this year, the global banking sector faced the biggest crisis since 2008 with the failures of two American financial institutions, Silicon Valley Bank and Signature Bank. Both banks had a high percentage of uninsured deposits. The failure was triggered when a large number of uninsured depositors simultaneously withdrew their deposits out of fear that the banks will be unable repay deposits due to large losses in their investment portfolios. The United States Federal Reserve ("Fed") took the unusual step of guaranteeing all deposits at both banks and providing emergency loans to ensure liquidity in the market. In Switzerland, Credit Suisse shares plummeted after its largest investors refused to inject further capital into the troubled bank. Swiss regulators stepped in and swiftly approved the purchase of Credit Suisse by its rival bank UBS without shareholders' approval.

The recent banking system stress has shaken up investor confidence in the sector, however, the banking crisis appears to be contained and contagion limited. Economists are expecting to see a pullback in lending which will weigh on economic growth. This restriction in available credit is

expected to act in similar fashion to interest rate increases as it restricts consumers' and businesses' ability to spend.

Most major central banks around the globe continue to signal that further interest rate increases are warranted this year, given elevated inflation rates. The central banks noted that they will continue to raise their benchmark rates, albeit at a slower pace than the prior year, until there is clear evidence that inflation has substantially returned to target levels. The recent banking system turmoil has made some central banks more cautious about their rate decisions for fear that too much tightening will trigger an economic downturn.

The International Monetary Fund ("IMF") provided an updated economic outlook in April. The global economy is forecasted to grow by 2.8%, a slight downward revision of 0.1% from January's prediction. The IMF cautions that inflation is proving to be stubborn despite synchronized tightening of monetary policies by most central banks around the world. The IMF now expects global inflation to fall to 7.0% in 2023, an upward revision of 0.4% from their earlier forecast, with a further drop to 4.9% next year. For 2023, the IMF forecasts the United States ("US") economy advancing by 1.6%, China growing by 5.2%, and an expansion of 1.5% and 0.8% for Canada and the Eurozone, respectively. The fund forecasts the United Kingdom's ("UK") economy to contract by 0.3% this year.

United States Overview

In March, the Federal Reserve Board (the "Fed") raised its benchmark rate for the ninth consecutive time over the past year, adding an additional 0.25%, bringing the range for the Federal Funds Rate to 4.75% - 5.00%. The US central bank raised interest rates despite the recent failures of two large regional banks. The collapse of these banks caused a panic in financial markets and forced the Fed to increase its benchmark rate by a smaller increment than it had initially planned. The Fed stated the recent bank failures would lead to tighter credit conditions, dampening borrowing and spending by consumers and businesses, thereby warranting a smaller rate increase.

The Fed signalled that further rate hikes may be appropriate. Analysts are forecasting one further rate hike of 0.25% in May, after which the Fed is expected to pause on further increases. First quarter Gross Domestic Product ("GDP") grew by 2.2%. However, the Fed is forecasting 2023 annual GDP growth of only 0.4%, which indicates that the central bank is expecting a large pull back in the economy during the remainder of this year.

To ease depositors' concerns, the Fed made emergency lending facilities available to ensure US banks can continue their operations. The central bank gave assurances that the banking sector is sound and resilient and reiterated that banking failures are isolated and contained.

The US labour market continues to show resiliency despite the interest rate hikes imposed by the Fed over the past year. The March unemployment rate fell to 3.5%, slightly higher than the 53-year low of 3.4% reported in January. For wages, the average hourly rate was up 4.2% from prior year. The central bank wants businesses to slow down hiring, while simultaneously wanting more Americans to look for work, which would increase the labour supply and ease wage pressures. US inflation came in at 5.0% in March compared to the same period last year, the lowest level since May 2021. Core inflation, which strips out volatile items like food and energy, came in at 5.6%. If tight labour market conditions and a high core inflation rate persist, the Fed may have to raise interest rates beyond the next meeting in May.

The US dollar has appreciated over the last year. The US dollar index, which measures the value of the currency, appreciated 17.0% in September 2022 compared to the beginning of that year. Since that time, the US dollar index shed some of its gains and fell by 10.3%.

Canada Overview

The Bank of Canada (“BOC”) held its key interest rate at 4.5% in April, marking the second consecutive rate announcement this year where the central bank has paused on further rate increases. BOC policy makers stated the previous rate hikes have been restrictive enough to slow down demand. The central bank reiterated its intention to hold rates steady and indicated that the market’s expectations of interest rate cuts this year to be an unlikely scenario. The central bank is forecasting Canadian GDP to come in at 1.4% this year.

Canada’s unemployment rate has held steady since the end of last year, with a reading of 5.0% in March. In the first quarter of this year, 208,000 jobs were added, with 151,000 of those positions materializing in January alone, surpassing economists’ forecasts. The central bank cautions that tight labour market conditions and sustained increases of four to five percent wage growth will make it difficult for inflation to return to its targeted 2.0%. In March, the average hourly wage grew by 5.3%, slightly ahead of the inflation rate. The central bank warned that, in addition to slower wage growth, the unemployment rate needs to rise to effectively drive down inflation.

Canada’s inflation rate came in at 4.3% in March, down from February’s reading of 5.2%. This is the lowest annual rate of inflation reported since August 2021. The biggest price growth continues to be seen in grocery bills, rising by 9.7% on a year-over-year basis in March, and continuing to outpace the overall rate of inflation. The BOC is expecting food costs to normalize in the coming months as production and distribution costs ease. The central bank expects inflation to come down to 3.0% this year and reach the 2.0% target next year. The BOC chair stated the bank stands ready to increase interest rates should inflation not fall in line with its expectations.

The central bank stated that rates need to remain high for the near future due to stubborn service price and wage pressures. In the coming months, the central bank will look for decreased inflation expectations in its survey of businesses, wage growth moderation and normalization of corporate pricing behaviour as signs that inflation is under control.

As the economy slows, fiscal measures must be targeted and aligned with monetary policy. The government has to balance providing affordability measures against fiscal restraints. The Trudeau government unveiled the 2023 budget in March with \$43 billion of net new spending over the next six years. The budget focused on a clean economy, affordability, and health & dental care.

The federal government will be investing \$21 billion over the next five years with tax credits provided to businesses that invest in clean economy initiatives. To help with affordability, \$2.5 billion will be spent on a “grocery rebate” which offers up to \$467 for families, \$234 for singles and up to \$255 for seniors. The dental program implemented last year will be expanded to cover people under 18, persons with disabilities, and seniors. The new spending for health and dental care this year is set to cost \$3.6 billion. The BOC factored in the newly announced federal spending and does not expect the 2023 budget to significantly fuel inflation.

British Columbia Overview

The British Columbia (“BC”) economy is forecasted to slow in 2023 with GDP growth estimated at 0.4%. BC’s unemployment rate came in at 4.5% in March with 14,300 jobs added while the annual rate of inflation was 4.7%. This marks the ninth consecutive month where BC’s inflation outpaced the national average. British Columbians continue to face high housing costs with rents rising by 13.2% on an annual basis in March. Due to higher home values, British Columbians also have higher mortgage servicing costs. In March, the national mortgage interest cost index rose by 26.4% year-over-year.

The BC government announced that, starting June 1st of this year, the minimum wage will increase from \$15.65 to \$16.75 which represents a 6.9% increase. Last year, the government introduced a policy which ties the yearly minimum wage increase to the prior year’s average rate of inflation. The government stated the policy is to ensure the lowest paid workers are not left behind. Many businesses were hoping the government would announce a cap on minimum wage increase arguing that they are still recovering from the effects of the pandemic. The government is in the process of crafting legislation to formalize the benchmarking of minimum wage increases to annual inflation. The Province argues that this provides businesses with certainty and affords them the ability to budget and plan accordingly.

To support British Columbians facing high costs of living, the government is providing enhanced BC Family Benefits and issuing Affordability Credits. The provincial government announced temporary family benefits top-ups of up to \$175 per child for the first three months of 2023. In April, eligible individuals can receive up to \$164 in BC Affordability Credits, while payments for children are \$41 per child. Families with two children can expect up to \$410. The government estimates that the Affordability Credit will benefit 85% of British Columbians. The two supports are income tested and targeted towards lower and middle-income individuals and families.

The government announced a number of housing and infrastructure supports. A \$500 million rental protection fund will help non-profit organizations purchase rental properties. A \$1.0 billion Growing Communities Fund was announced to help municipalities build community infrastructure and amenities to meet the demands of population growth. This funding will be distributed to all 188 BC municipalities and regions. \$500 million of funding was announced for BC Ferries which will prevent fares from rising by a projected 10.0% over the next few years. The funding will also help electrify the ferry fleet. The various affordability measures announced since last fall are expected to cost \$2.0 billion.

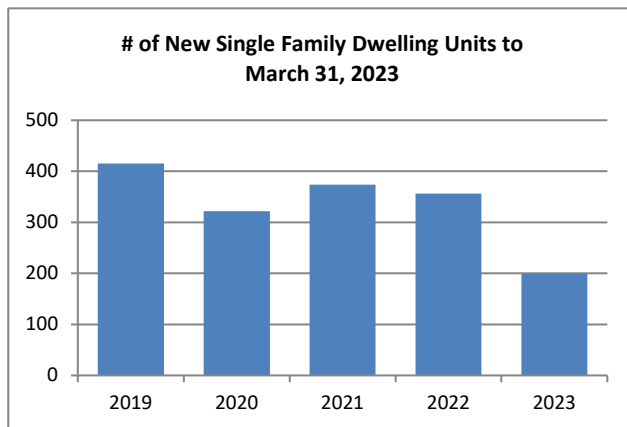
The BC government tabled its 2023 budget projecting a \$4.2 billion deficit for the upcoming fiscal year. Over the next three years, the provincial government is forecasting total deficits of \$11.0 billion. The government also announced a renters’ rebate, increased welfare payments and increased family and carbon tax benefits. The renters’ rebate and affordability supports are all income tested. The government announced it will spend \$6.4 billion more on health care and allot \$4.2 billion to build more homes over the next three years.

City of Surrey Overview

Residential development in the City is continuing to shift from single family to multi-family, highlighted by a 38% increase in new multi-family dwellings as compared to a 44% drop in new single-family dwellings. In the non-residential development category, the City has seen a decrease in the number of permits and value of construction in Industrial, Commercial & Institutional (“ICI”) development segments. Since ICI projects are high construction value in nature, even a slight change in the number of such projects could result in a substantial change in the value of construction. Overall, in alignment with a slowdown in real estate activity, the City has seen a drop in the total value of construction in this quarter as compared to the same quarter in 2022. However, the City has seen a significant increase in permit fees collected in the first quarter in 2023 as compared to 2022. For most development categories, with the exception of residential single-family, there is a slight time lag between the time permit fees are collected and the permits are issued. Due to this timing difference, the increased collection of Permit fees in this quarter can be a leading indicator for an increase in future permitting performance and a potential increase in construction activity in the near future.

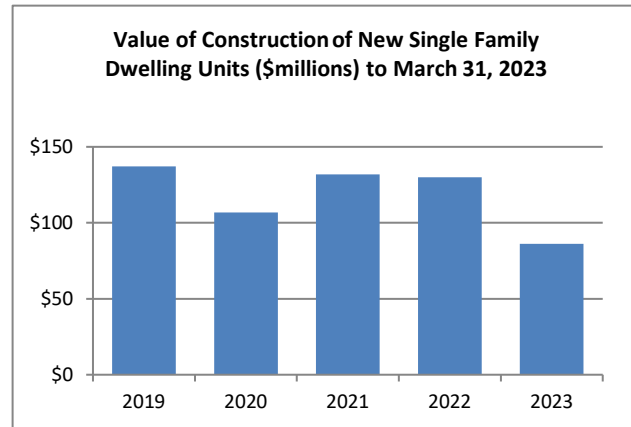
City of Surrey’s Key Performance Indicators

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



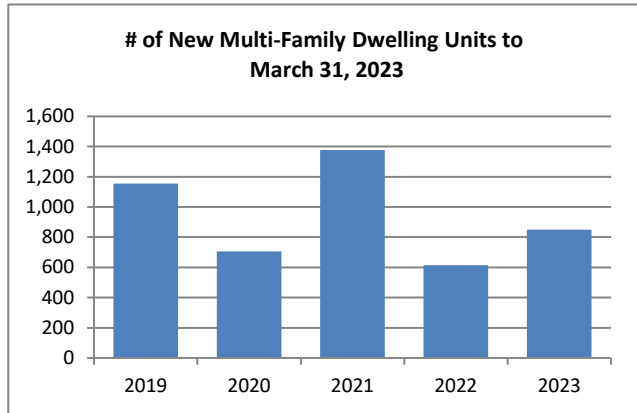
Graph 1

Due to a continued shift in the residential development activity from single-family to multi-family, new Single Family Dwelling units have declined by 44% in this quarter, as compared to the same quarter in 2022.

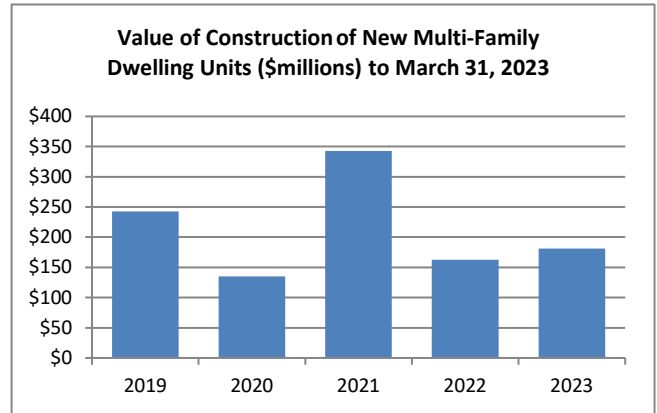


Graph 2

Due to a decline in the number of new single-family dwelling units issued permits in this quarter as compared to the same period last year, the value of construction of these units has correspondingly decreased by 34% when compared to the same period last year.



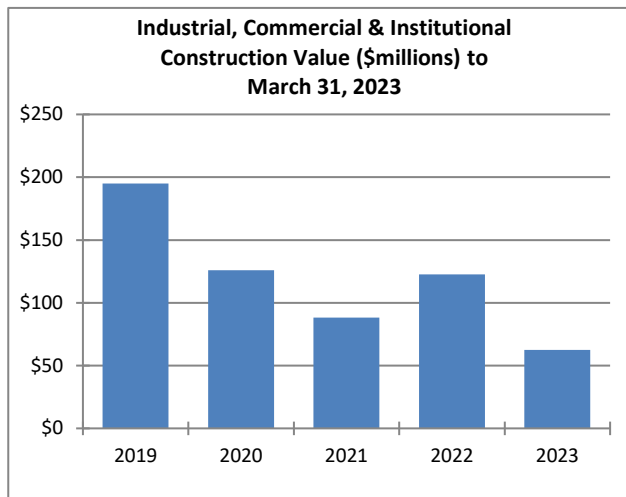
Graph 3



Graph 4

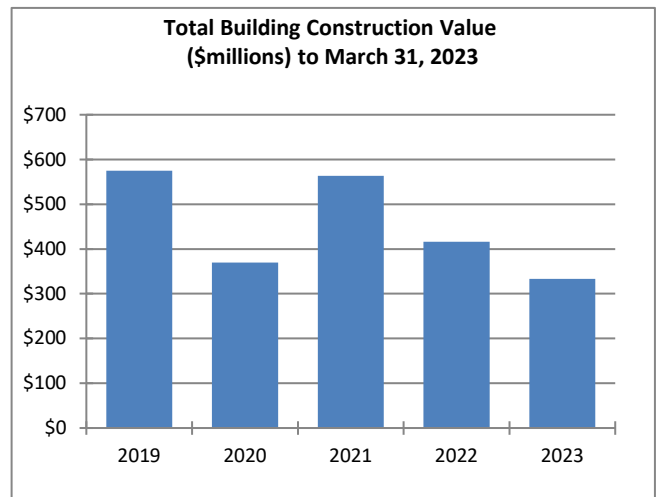
As discussed above, there has been an overall increase in development activity in multi-family residential projects. This quarter has seen an increase in permits for multi-family dwelling units by 38%.

Consistent with the increase in the number of permits for new multi-family dwelling units in this period as compared to the same period last year, the value of construction for these units has increased by 12% when compared to the same period last year.



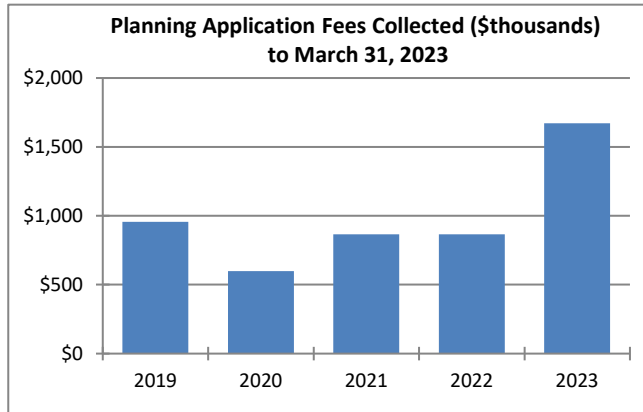
Graph 5

Construction value of ICI permits for the first three months of 2023 is lower by 49% as compared to the same period in 2022. This is primarily due to some significantly large projects that received permits in the first quarter of 2022, such as a large industrial warehouse project in Campbell Heights.



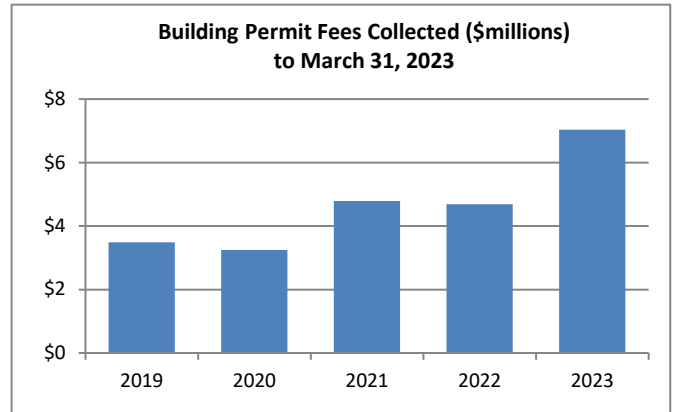
Graph 6

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 lower by 20% compared to the same period last year.



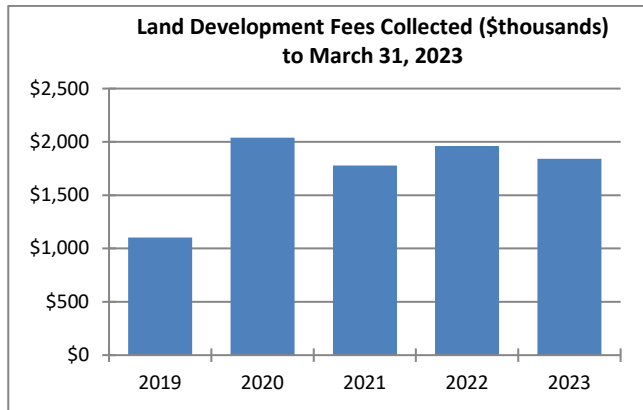
Graph 7

Due to continued overall planning and development activity within the City, planning application fees collected in the first three months of the year were robust, coming in 93% higher as compared to those collected in the same period last year.



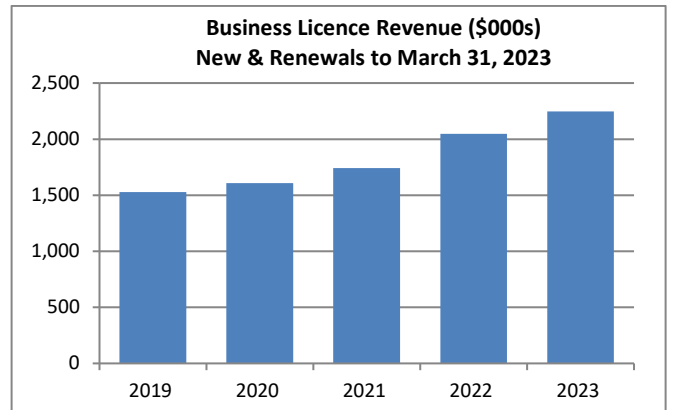
Graph 8

Due to continued overall development activity within the City, building permit fees collected in the first three months of the year remained strong, resulting in a 50% increase compared to those collected in the same period last year.



Graph 9

Land Development fees collected for the first three months of 2023 are lower by 6% as compared to the same period in 2022. Overall, this fee collection is consistent with the average of land development fees in the first three months of four prior years.

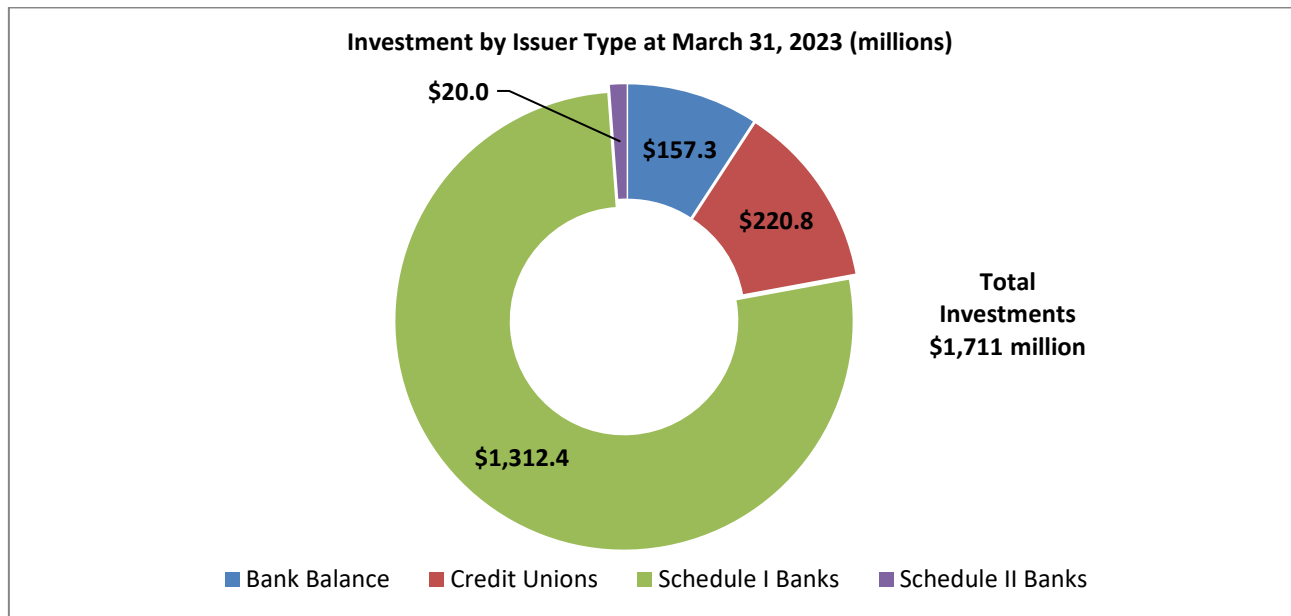


Graph 10

Consistent with first quarter increases in the last few years, business licence revenue in the first three months of 2023 increased by 10% as compared to the same period last year. This increase aligns with a 6% increase in the number of businesses paying for business licences in Surrey in this quarter 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 \$1,711 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.

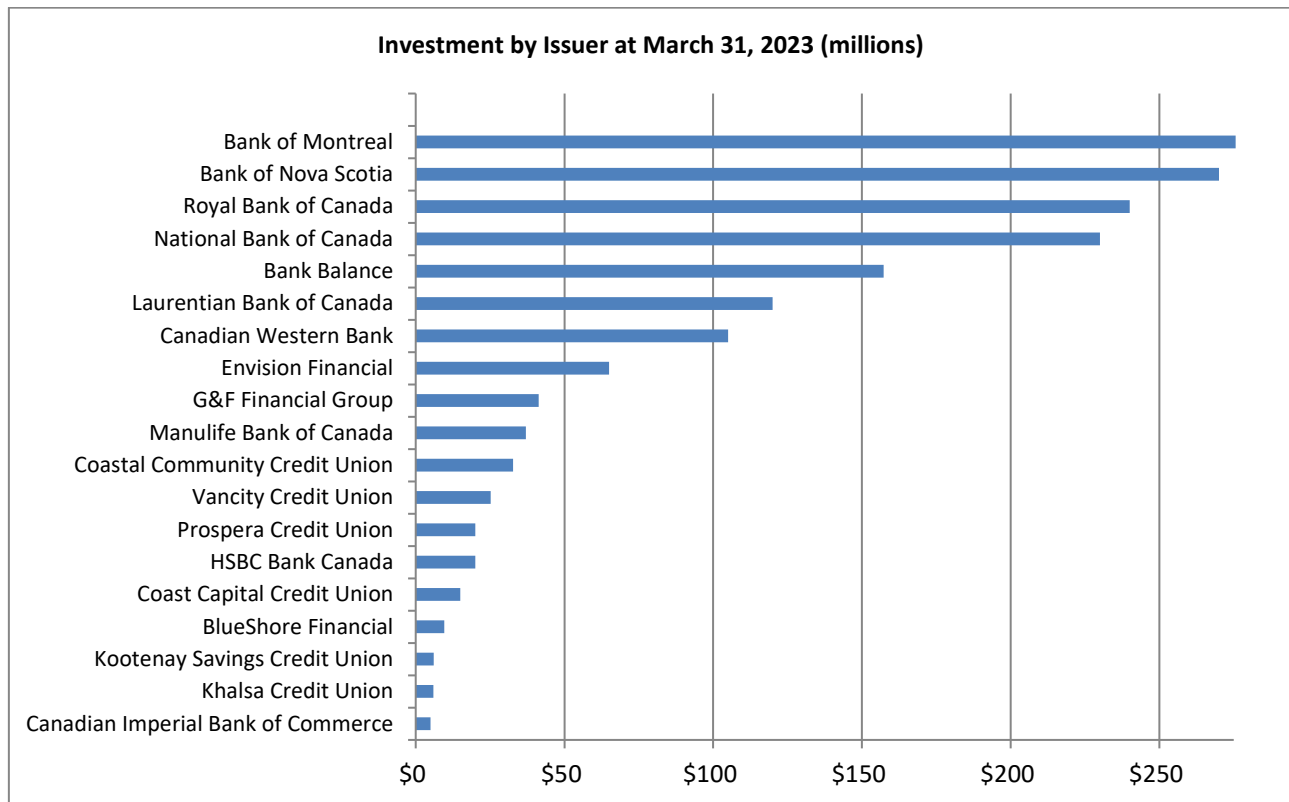


Graph 11

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

Diversification

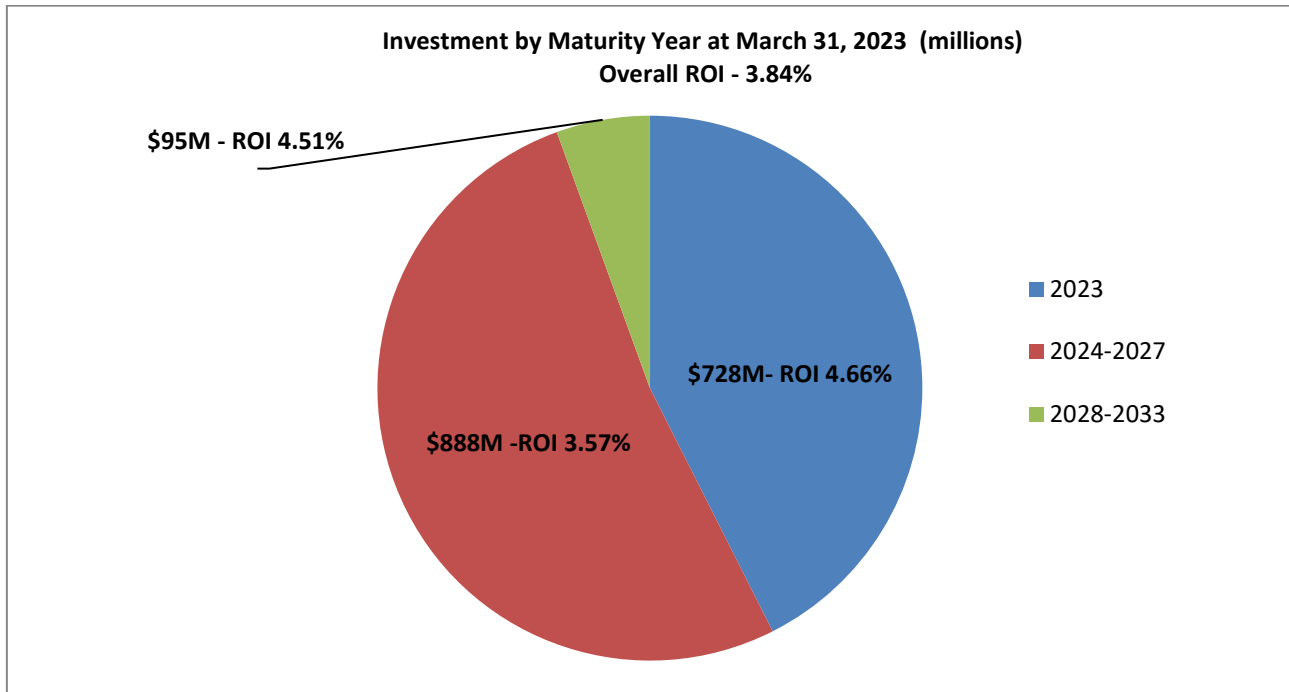
In order to reduce overall portfolio risk, the City diversifies its investment holdings across a range of security types and financial institutions. Graph 12 shows a listing of the City's portfolio by Financial Institution.



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.



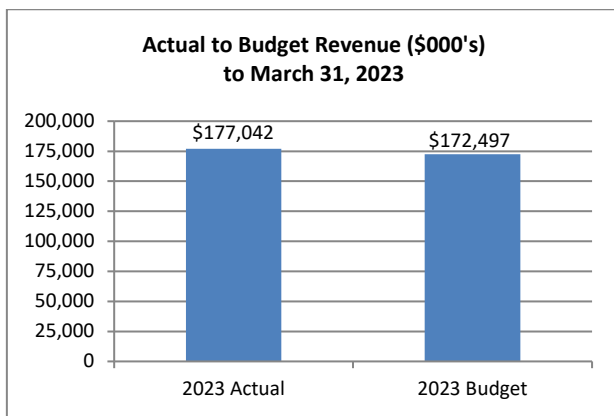
Graph 13

Return on Investment

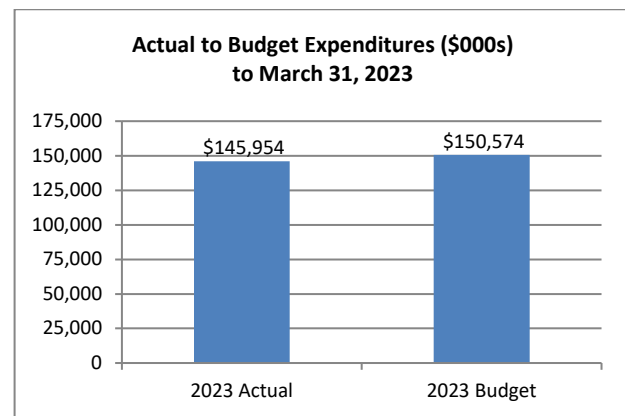
During the three-month period ending March 31, 2023, the City’s investment portfolio earned a combined return of approximately 3.84% (during the three-month period ending March 31, 2022 – 1.55%) while maintaining investment security as outlined in the City’s investment policy. The City strives to earn 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 first 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

The 2023 adopted Policing Services budget is predicated on the City retaining the RCMP as POJ. It is based on various assumptions driven by multiple parties (e.g., British Columbia, RCMP, the Surrey Police Board (“Board”) and the City). On April 28, 2023, the Province released a report, supporting their recommendations regarding policing in Surrey. The report includes a series of requirements, which are currently under review by City staff.

In relation to the adopted Q1 budget for Policing Services, the following is the Q1 variance for each of the three components:

- **City Police Support Service** currently has a favourable variance of \$372,000 primarily due to revenue from security clearance being higher than the budget, and cost savings from vacancies and timing of expenditures.
- **Surrey Police Service** (“SPS”) currently has a favourable variance relative to budget of \$4,877,000 primarily due to timing of expenditures and savings from salaries due to difference between the budgeted and the hired SPS members.
- **RCMP Contract** currently has a favourable variance of \$148,000 primarily due to timing of expenditures.

Staff will be including a forecast of the potential variance in relation to Policing Services for fiscal 2023 as part of the Q2 Quarterly Financial report.

Fire Department currently has a slight favourable variance of \$78,000 as result of timing of salaries and operating expenditures.

Engineering Services-General Operating currently has a slight unfavourable variance of \$22,000, primarily due to higher-than-expected land development revenues, offset by higher than budgeted salaries and operating costs, primarily due to timing of expenditures.

Parks, Recreation & Culture Department currently has a favourable variance of \$209,000. This is primarily due to vacancies and timing of expenditures.

Surrey Public Library currently has a favourable variance of \$117,000. This is primarily due to vacancies and timing of expenditures.

Planning & Development Department which also includes Civic Facilities, currently has a favourable variance of \$960,000. Since certain Planning & Development revenues are recognized over a one-year or two-year period, permit, inspection, and application revenues in this year are favourable due in part to higher than expected development related fee collections in 2022.

Mayor and Council is currently on budget.

City Grants is currently on budget.

City Manager’s Department has a slight favourable variance of \$24,000 primarily due to the timing of expenditures and savings from vacancies.

Community Services Department currently has a favorable variance of \$324,000, primarily due to timing of expenditures and savings from vacancies.

Investment & Intergovernmental Relations Department currently has a favourable variance of \$28,000, primarily due to timing of expenditures.

Finance Department currently has a favorable variance of \$75,000, primarily due to timing of expenditures and savings from vacancies.

Corporate Services Department has a favourable variance of \$82,000, due to better-than-expected business license revenues and the timing of expenditures.

CONCLUSION

Staff will continuously monitor the City's financial status relative to budget as we enter the second quarter of fiscal 2023 and will take proactive measures to address any unplanned financial challenges.

Kam Grewal, CPA, CMA
General Manager, Finance

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

2023 1st QUARTER COUNCIL REPORT
EXECUTIVE SUMMARY - REVENUES & EXPENDITURES
\$ 000's

	2023: 1st Qtr YTD Actual	2023 YTD BUDGET	2023: 1st Qtr YTD Variance	2023 ANNUAL BUDGET
REVENUE SUMMARY				
Net Taxation	122,714	122,714	-	507,917
Secondary Suite Infrastructure Fee	7,186	7,186	-	24,931
Other Corporate Fees	1,095	950	145	4,400
Investment Interest	11,374	11,160	215	57,336
Provincial Casino Revenue Sharing	827	827	-	3,308
Carbon Tax Rebate	294	294	-	1,175
Other Trsf from Government	-	-	-	18,176
Penalties & Interest on Taxes	49	28	21	5,275
Corporate Leases	3,300	3,286	14	13,145
Other Revenues	-	-	-	-
Non-Tax Revenues	24,125	23,730	395	127,746
Program Revenues	30,202	26,053	4,149	98,025
TOTAL REVENUES	177,042	172,497	4,544	733,688
EXPENDITURE SUMMARY				
Program Expenditures, net of transfers	143,323	146,445	3,122	682,153
Council Priorities	65	65	-	260
Fiscal Services	52	42	(11)	167
Debt Interest & Principal	2,363	2,363	-	31,243
Other	152	1,660	1,508	23,063
TOTAL EXPENDITURES	145,954	150,574	4,619	736,886
CORPORATE TRANSFER SUMMARY				
Transfer to /(from) Operating Sources	(4,624)	(4,518)	105	(18,074)
Transfer to /(from) Capital Sources	673	-	(673)	-
Transfer to /(from) Reserve Sources	3,749	3,749	-	14,996
Transfer to /(from) Surplus	2,609	(30)	(2,639)	(120)
TOTAL TRANSFERS	2,408	(799)	(3,207)	(3,198)
Surplus (Deficit)	28,680	22,723	5,956	-
Trsf (To)From Unapprop Surplus	(28,680)	(22,723)	(5,956)	-
BALANCED BUDGET	-	-	-	-

1st Quarter YTD Actual to Budget Variance:

\$ 5,956

Appendix "II"

2023 1st QUARTER COUNCIL REPORT DEPARTMENTAL DETAIL \$ 000's

PROGRAM REVENUES	2023: 1st Qtr YTD ACTUAL	2023 YTD BUDGET	2023: 1st Qtr YTD Variance	2023 ANNUAL BUDGET
City Police Support Service	2,325	2,175	150	8,082
Surrey Police Service	-	-	-	-
RCMP Contract	-	-	-	-
Fire	395	417	(22)	3,991
Engineering Services	3,092	2,237	855	8,946
Parks, Recreation & Culture	8,869	8,803	66	35,211
Surrey Public Library	394	349	45	1,386
Planning & Development	10,178	8,815	1,363	28,258
Mayor & Council	-	-	-	-
City Grants	-	-	-	-
City Manager	-	-	-	-
Community Services	1,367	-	1,367	-
Invest. & Intergovernmental Relations	-	-	-	-
Finance	263	366	(103)	1,462
Corporate Services	3,318	2,892	427	10,689
TOTAL PROGRAM REVENUES	30,202	26,053	4,149	98,025

PROGRAM EXPENDITURES NET OF TRANSFERS	2023: 1st Qtr YTD ACTUAL	2023 YTD BUDGET	2023: 1st Qtr YTD Variance	2023 ANNUAL BUDGET
City Police Support Service	8,207	8,429	222	124,071
Surrey Police Service	16,478	21,355	4,877	48,751
RCMP Contract	34,533	34,681	148	165,225
Fire	17,864	17,964	100	79,467
Engineering Services	3,316	2,439	(877)	13,968
Parks, Recreation & Culture	28,245	28,387	143	110,651
Surrey Public Library	5,616	5,687	72	22,692
Planning & Development	8,986	8,583	(404)	36,389
Mayor & Council	517	517	-	2,123
City Grants	40	40	-	1,179
City Manager	376	400	24	1,712
Community Services	1,946	903	(1,043)	3,921
Invest. & Intergovernmental Relations	362	390	28	2,050
Finance	3,476	3,653	177	15,443
Corporate Services	13,362	13,017	(345)	54,511
TOTAL PROGRAM EXPENDITURES	143,323	146,445	3,122	682,153

NET PROGRAM	2023: 1st Qtr YTD ACTUAL	2023 YTD BUDGET	2023: 1st Qtr YTD Variance	2023 ANNUAL BUDGET
City Police Support Service	5,881	6,254	372	115,989
Surrey Police Service	16,478	21,355	4,877	48,751
RCMP Contract	34,533	34,681	148	165,225
Fire	17,469	17,547	78	75,476
Engineering Services	224	202	(22)	5,022
Parks, Recreation & Culture	19,375	19,584	209	75,440
Surrey Public Library	5,221	5,338	117	21,306
Planning & Development	(1,191)	(232)	960	8,131
Mayor & Council	517	517	-	2,123
City Grants	40	40	-	1,179
City Manager	376	400	24	1,712
Community Services	579	903	324	3,921
Invest. & Intergovernmental Relations	362	390	28	2,050
Finance	3,212	3,287	75	13,981
Corporate Services	10,043	10,125	82	43,822
NET PROGRAM TOTAL	113,120	120,392	7,271	584,128