HALIFAX

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Item No. 5
Committee of the Whole on Budget
January 20, 2021

TO: Chair and Members of Budget Committee (Standing Committee of the Whole on Budget)

SUBMITTED BY: Original Signed by

Jacques Dubé, Chief Administrative Officer

DATE: December 29, 2020

SUBJECT: Strategic Initiatives Funding Plan

ORIGIN

On December 15, 2020 Regional Council passed by motion the Fiscal Sustainability Strategy. As part of the Fiscal Sustainability Strategy staff are to: ***Develop, "Strategic Initiative" Reserves, as part of the 2021/22 budget process, for projects that are tied to an approved Council strategy and are significant enough to lead to a discernable increase in the tax rate or special funding that is outside the normal budget process. This should include any required changes to debt and reserve policies and should be eligible to be funded through dedicated tax levies.***

LEGISLATIVE AUTHORITY

Halifax Charter, section 93(1) - The Council shall make estimates of the sums that are required by the Municipality for the fiscal year;

Halifax Charter, section 79A (1), subject to subsections (2) to (4), the Municipality may only spend money for municipal purposes if (a) the expenditure is included in the Municipality's operating budget or capital budget or is otherwise authorized by the Municipality;

Halifax Charter, section 35(2)(d)(i) - The CAO can only authorize budgeted expenditures or within the amount determined by Council by policy;

Halifax Charter, section 120(6) - The Municipality may maintain other reserve funds for such purposes as the Council may determine;

RECOMMENDATIONS ON PAGE 2

RECOMMENDATION

It is recommended that Budget Committee direct the Chief Administrative Officer to:

1. Include in the 2021/22 to 2024/25 Operating Budget dedicated funding for strategic initiatives in the form of an annual budget allocation to Reserves, including the Principal and Interest Reserve Q631 that is used to fund debt payments for initiatives directly linked to advancing the objectives of HalifACT2050; advancing the Rapid Transit Initiative, and renovations to the Ragged Lake Bus Terminal; and advancing the Integrated Mobility Plan and other projects as identified by Regional Council that are deemed to be strategic initiatives; and,

2. return to Regional Council no later than June 2021 with a revised Reserve strategy including a review of all reserve business cases, recommendations on the number and classification of reserves and their relationship to Strategic Initiatives; and,

3. as part of the Fiscal Sustainability Strategy return to Regional Council with revised debt levels and measurement and their relationship to the Strategic Initiatives.

BACKGROUND

The municipality has entered a new phase of economic growth. The growth in its population and economy has become much more rapid. Prior to the pandemic, the Halifax Regional Municipality was one of the fastest growing jurisdictions in the country. The Halifax region is much richer on a per-capita basis than in 1996 and its financial position has improved markedly. This growth brings significant opportunities as the municipality expands and attracts many newcomers, including immigrants. There is every reason to believe the end of the pandemic will see this trend continue, and possibly even strengthen, and that new opportunities will arise.

Council has adopted a number of important, ambitious strategies in response to the public and Halifax's prominence as a regional hub and one of Canada's Big Cities, the Regional Plan, Green Network Plan, Urban Forest Master Plan and Culture and Heritage Priorities plan to name a few. In addition to those existing strategies new major initiatives such as the Integrated Mobility Plan (IMP), HalifACT2050, fleet electrification and the Rapid Transit Strategy are also underway in the region. In the past HRM approved long-term strategies without a clear sense of the overall long-term financial picture, how such initiatives will be funded, or what the various alternatives and opportunity costs are. Projects such as these put increasing pressure on existing services and, without a clear financial plan, the initiatives themselves are at risk of failure. Moving forward with these initiatives also puts considerable pressure on the capital plan and HRM's ability to maintain its current stock of assets or increase its assets in response to growth.

Capital assets are critical to providing services. Most services require capital assets such as vehicles (police cars, fire truck, transit buses, works equipment), buildings (recreation centers, rinks, libraries, depots) and parks as well as linear assets such as bike lanes, roads, sidewalk and active transportation networks. As of March 31, 2020, these assets have a book value of $3.8 billion. The stewardship of capital assets has significant financial consequences. Assets are acquired through HRM's capital budget and funded through a number of means including debt issuance, reserve funds, capital from operating (transferred from the operating budget) or cost-sharing through intergovernmental infrastructure programs. The total cost of capital assets is much broader than acquisition costs. Assets need to be operated and maintained. The total cost for the life of the asset is known as life-cycle costs. Operating components often cost considerably more than the initial acquisition costs and are a key driver of costs.

In 1999, HRM responded to its growing debt level and capital asset requirements through the development of the Multi -Year Fiscal Strategy. In its debt service plan HRM's debt was to fall by 3% per year and its investment in pay-as-you-go capital was to increase annually by 3% over CPI. This policy has been very successful in reducing HRM's total debt by over $100M in approximately 20 years. As of 2020, HRM has approved or has outstanding debt of $235.7 million.

Regional Council has also used its reserve policies to direct funds to strategic projects. In 2014 it established two specific reserves to fund strategic "planned" and "potential" projects. Funding came through the sale of specific properties and the allocation of 1 cent in tax revenues. Many of the "planned" projects are now completed and funding now appears in the Strategic Capital Reserve (Q606).

While the debt policy has been successful at reducing debt levels, and Regional Council's approach on Strategic "planned" projects was successful, HRM has insufficient capital funding to both maintain state of its current assets and to fund growth-related and future strategic assets. Rather, inflationary pressures are increasing the costs of base capital items at the exact same time that the municipality is trying to allocate funding to much needed strategic initiatives. Hence there is intense competition between renewal, growth and strategic projects for the limited capital funds that are available. This has led to a deterioration in the existing asset base (along with higher operating costs) and delays in funding growth related and strategic projects.

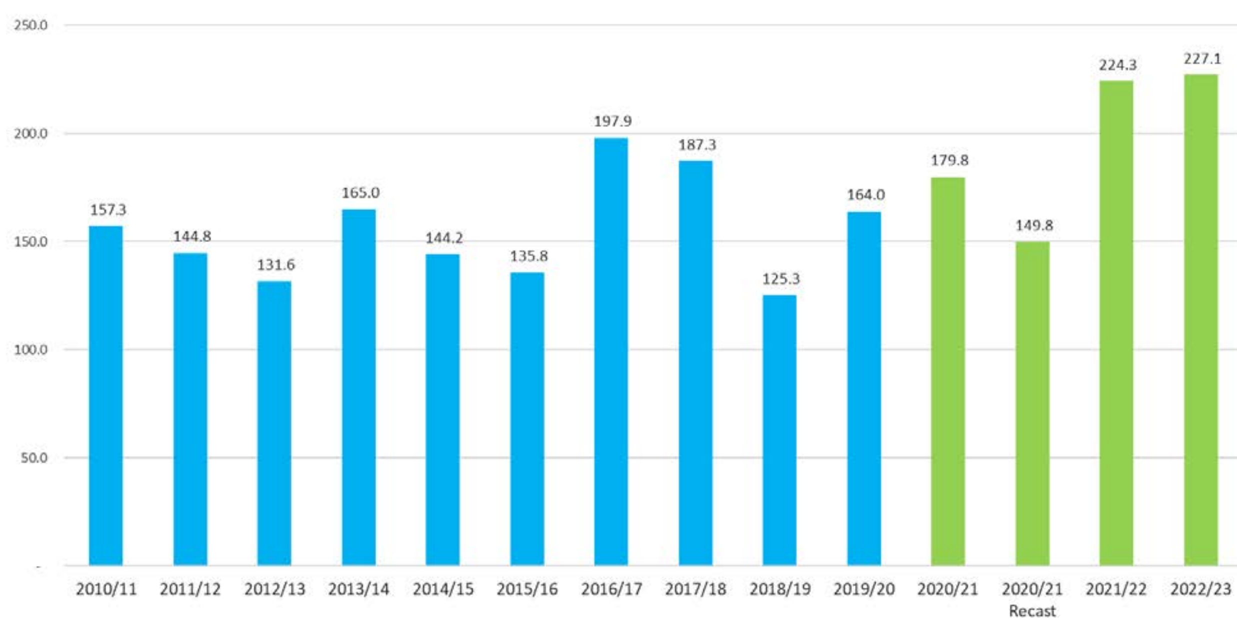
DISCUSSION

This report is seeking direction on the establishment of a strategic initiative funding plan in order to advance city building initiatives that Regional Council have identified as key priorities. The discussion of strategic initiative capital funding cannot occur in isolation of the existing base capital budget.

Capital Budget – Base

Since 2010/11 HRM's gross capital budget has fluctuated between a low of $125.3M in 2018/19 and a high of $197.9M in 2016/17, the average capital budget over the ten-year period is $155.3M. This budget amount is the total for renewal (state of good repair), growth projects and new initiatives of Regional Council. The size of the capital budget in any one year is often dictated not only by available funding but by cost-sharing and the nature of specific projects that are underway. As a general statement, HRM has the financial and staff capacity to deliver approximately $150M in capital per year. The following chart (Figure A) illustrates the projected capital plan for 2020/21, it is the starting point for the development of the 2021/22 capital budget which will be presented to Regional Council for debate in February.

Figure A – Gross Capital Budget Trend (In Millions) ***as at 2020/21***



Due to inflationary and other pressures on capital projects and the growing number of strategic and growth-related projects, there is intense competition for limited capital funds. Every year staff spend an inordinate amount of time trying to "fit" the capital projects within the existing budget envelope. The process results in projects being "pushed out" with the hope of being able to accommodate them in future years budgets, which is very frustrating for residents and Regional Council. In an attempt to start projects and to meet Council direction, staff often phase the projects over multiple years, essentially managing the project to the budget rather than establishing the proper budget allocation. This results in projects costing more than they should and project managers having to manage too many projects at one time, which puts pressure on their ability to deliver the projects in a timely manner.

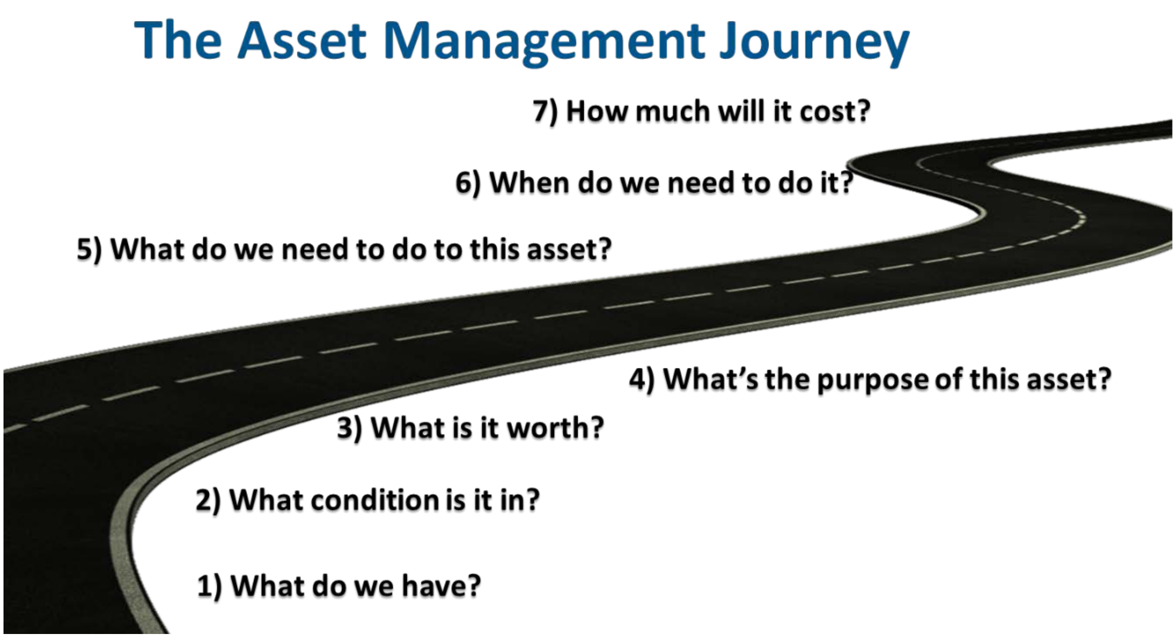
The introduction of the Integrated Mobility Plan (IMP), Moving Forward Together (MFTP), HalifACT2050, fleet electrification and Bus Rapid Transit has resulted in crowding out of other capital projects. In the March 2020/21 proposed budget approximately 30% of the of the proposed $179.8M capital budget was directed to IMP, MFTP and HalifACT2050. This resulted in funds diverted from renewal, hence further deterioration of the condition of existing assets. As funds are diverted from renewal projects the condition index of the asset erodes. This is being witnessed in the pavement condition index (PCI). In 2018 the index was 71.7. In 2020 it is estimated that the index will fall to 67.9. Staff in TPW estimate that there will need to be $48M per year invested in street renewal in order to maintain the network average PCI at current levels.

Asset Management

In 2017, HRM introduced Enterprise Asset Management and launched CityWorks, a computerized maintenance management system to track the lifecycle costs of HRM's assets. Asset management in HRM is defined as, "*The practice of managing assets to minimize the total cost of owning and operating assets while delivering the desired service levels.".*

Critical to sound asset management practice is investing in the assets that you own in order to achieve the fullest lifespan of the asset. In order to achieve this, you have to know what assets you have, what condition they are in, what the desired service level is from the asset, should you invest in the asset or dispose of it and how much should you invest - if it is warranted. Asset management is often described as a journey, see Figure B below.

Figure B – Asset Management Planning Framework



HRM has established a number of objectives to enhance asset management and ensure the long-term sustainability of HRM assets and more importantly the ability to deliver services to HRM residents.

Objectives of asset management are longer term in nature and include the following:

- Continued transition from annual capital budget to **long-term strategic capital planning.** This will see the development of capital budgets that are based on asset management plans which outline proactive asset rehabilitation and replacement timelines and integrate these costs into long term fiscal planning;
- Implement HRM **Asset Management Policy.** The asset management policy will outline high-level principles for asset investment decision-making. The Policy reflects Council's commitment in the consistent application of asset management practices to achieve long-term sustainable asset outcomes such as safe, reliable, and cost-effectively managed.
- Implement **Asset Management Plans** (Lifecycle analysis & modelling) for major asset groups. Asset Management Plans will speak to inventory held to provide services, projection of future service demands, recommended investments in assets to maximize service life while minimizing whole life cost, and risk and opportunities facing the assets and services they support.
- Implement State of Infrastructure Report which will provide municipal asset stakeholders with regular information on asset physical condition and show the impacts over time of HRM's investments to maintain infrastructure for delivering services.

Reporting on the condition of HRM's assets will occur through the State of the Infrastructure Report, on a four-year cycle. State of the Infrastructure Reports tend to be a very formal report, most jurisdictions tend to produce State of the Infrastructure Reports every 2 to 4 years due to the level of effort to update the information for various asset class inspections. A number of jurisdictions do report on an annual basis on the current condition of their assets through their asset management plans, the investment that is being made, service delivery standards and improvements that are occurring. By linking these to Regional Council Strategic Priorities taxpayers will be able to see how those priorities are being advanced.

In order to successfully stabilize the condition of HRM's assets, and its services to the public, the municipality needs to establish and budget for the maintenance and replacement of those assets. A base capital budget of $150M is not sufficient to maintain HRM assets and follow sound asset management practice. Determining the appropriate funding level for the base capital budget and the resulting timeline for asset renewal investment can best be established through robust asset management plans. These plans will lay the foundation for stronger budgeting and will form an essential foundation for HRM's long term fiscal plan.

Capital Budget - Strategic Initiatives

As stated in the Fiscal Sustainability Strategy, Regional Council has launched a number of key city building initiatives that are too large to be funded within the existing capital budget envelope. These initiatives are referred to as strategic initiatives. Staff have defined strategic initiatives as: *"those whose implementation would require a discernible increase to the tax rate in order to move forward*". Strategic Initiatives often share certain common characteristics:

- They represent an element of a key strategy approved by Regional Council;
- They are most likely capital and may represent a family of capital projects;
- They are significant financial investments that cannot be accommodated within the existing budget without an unintended service disruption or a tax increase;
- Their implementation requires significant planning over multiple fiscal years;
- They represent new initiatives and are not ongoing in nature;
- The issuance of debt for these initiatives that would be above the current debt policy targets and may require special reserve business cases;
- if debt is issued, then the term of the debt should match the life of the asset; and,
- They require ongoing review and oversight as many of the future costs and savings cannot yet be ascertained.

A preliminary review of strategic initiatives has estimated that over the next 10 years, HRM would require nearly $1.5B in funding to advance strategic initiatives. Within the existing funding strategies HRM will not be able to move forward with these initiatives without establishing dedicated funding resources, as discussed in the December 15th, 2020 Fiscal Sustainability Strategy.

Currently projects that would fall under the category of strategic initiatives include those under the Rapid Transit program, Integrated Mobility Plan, Moving Forward Together Plan, HalifACT2050, and the Windsor Street Interchange. Collectively these are estimated to cost almost $1.5B in capital (after cost sharing), plus operating costs. The latter is estimated to cost from $23M to $117M depending on the extent of operational savings. It is anticipated that other initiatives will be adopted or advanced by Regional Council that met the characteristics of a strategic inactive, when that is the case, they will be folded into the funding plan.

Indicative Capital costs are illustrated in Figure C, these costs are being represented as the net cost to HRM, if HRM takes out debt to fund these initiatives the debt would be based on the gross cost less cost sharing. As an example, the Ferry Rapid Transit Project is estimated to be in the $215M range once the proposed federal and provincial funding has been netted against the project the cost to HRM is estimated to be $61M. It should be pointed out that these are preliminary cost estimates and are being used for planning purposes. If Regional Council direct the CAO to move forward with the Strategic Initiatives Funding Plan a more detailed review of criteria, projects and costing will be undertaken.

Figure C – Preliminary Ten-Year Strategic Project Funding Requirements

	NET CAPITAL BUDGET REQUIRED					
	Year 1	Year 2	Year 3	Year 4	Years 5-10	TOTAL
Integrated Mobility						
Active Transportation	-	1.5	1.5	-	51.0	54.0
Integrated Land Use Planning	-	7.3	5.8	0.7	54.2	67.9
Transportation Capital Asset Renewal	5.0	5.0	5.0	5.0	268.2	288.2
Bus Rapid Transit	-	1.0	13.8	20.3	181.0	216.1
Ferry Rapid Transit	0.9	7.1	14.5	16.3	22.3	61.1
Integrated Mobility Land Acquisition Strategy	1.0	2.0	13.4	29.8	4.7	50.9
Strategic Multi- Modal Mobility Corridors	-	-	-	-	129.3	129.3
Sub-Total	**6.9**	**23.9**	**53.9**	**72.1**	**710.7**	**867.5**
Environment						
Municipal Fleet Electrification	-	2.3	2.8	2.8	4.1	12.0
Critical Municipal Infrastructure Adaptation	-	0.7	5.0	5.0	25.0	35.7
Deep Energy Retrofit Program (Municipal Buildings)	2.7	10.7	22.3	23.7	98.0	157.4
Electrification of Halifax Transit	14.7	(8.3)	(3.9)	110.4	242.0	354.9
Sub-Total	**17.4**	**5.4**	**26.2**	**142.0**	**369.0**	**560.0**
Prosperous Economy						
Windsor Street Exchange Redevelopment Project	0.5	1.9	6.3	4.3	-	12.9
Sub-Total	**0.5**	**1.9**	**6.3**	**4.3**	**-**	**12.9**
Total	**$24.7**	**$31.1**	**$86.4**	**$218.4**	**$1,079.7**	**$1,440.4**

As council moves forward with other city building initiatives, decisions will need to be made on capital funding to see if they meet the criteria for Strategic Initiative Funding.

It should be noted that the Cogswell St. Redevelopment Project certainly meets the criteria of a strategic initiative and is a city building project. It has not been included in the strategic initiative funding plan as it will be funded through debt, the repayment of which will be funded through the sale of the lots.

Currently there are a number of projects that fall under a strategic initiative that have been funded through the base budget but are modest enough they have not affected overall funding levels. These projects should

continue to be funded through the base budget. An example of this is energy efficiency; on an annual basis there is approximately $2M in the capital budget for energy efficiency projects. These projects advance the objectives of HalifACT however any significant expansion to this program would be captured under the strategic initiative funding plan.

Strategic initiative funding is intended to be used for the initial capital asset only; renewal of the asset should be planned as part of the base capital budget. An example of this would be the electrification of buses. The initial purchase of the buses is a strategic initiative and will have a dedicated funding source. Future replacement of electric buses would be classified as renewal and would be funded within the existing base capital budget.

In addition to strategic initiatives, in July 2014 Regional Council, debated a list of planned and potential projects such as redevelopment of the Halifax Forum, the library masterplan, and construction of a new police headquarters. These are meant to be funded through the strategic capital reserve (Q606). “Planned” projects are those that were intended to go ahead while “potential” projects were aspirational in nature and a specific capital project has not yet been approved by Council. As part of the strategic initiatives funding plan Regional Council will be asked to look at these projects to determine if the remaining planned or potential projects are still relevant and, if so, what funding mechanism should be used for those projects. The Strategic Capital Reserve Business Case would be rewritten as part of the broader reserve review.

Debt

HRM has done a very good job of reducing its debt levels. Its emphasis, however, has been on reducing the debt that is outstanding as opposed to looking at what an appropriate level of debt should be for an organization the size of HRM. HRM debt policy has focused on reducing this debt in favor of capital for operating, in order to support asset renewal. It did not focus on the use of debt for growth purposes and city building initiatives. This has left HRM with insufficient capital funding to maintain assets and support growth and strategic projects. A revised debt policy would establish when debt should be used, the term of debt that should be taken out, which assets should fall under debt financing and the appropriate measure(s) of debt affordability. The establishment of a debt policy is much broader then just looking at strategic initiatives. It should encompass borrowing for all capital the municipality will undertake and must fit in to the overall fiscal sustainability strategy.

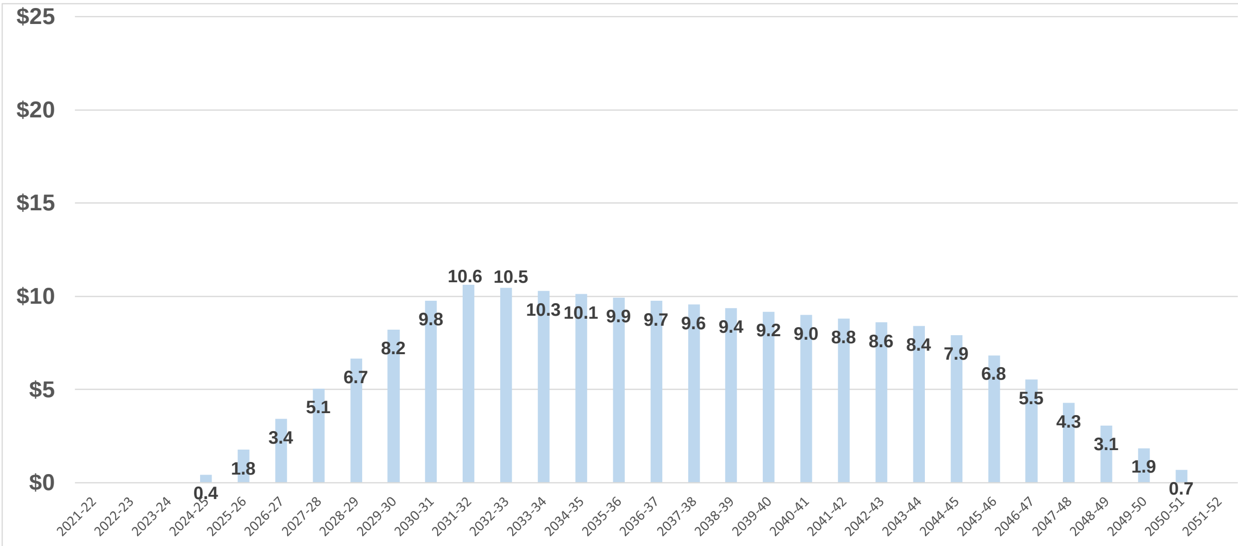
Debt should be used to finance intergenerational projects or those strategic initiatives that cannot be accommodated within reserves. Intergenerational projects are projects that span a long-term timeframe typically 20 to 40 years. Using debt to finance these projects ensures that those that are using and benefiting from the asset are the ones that pay for the asset.

As a general rule the term of the debt should match the lifespan of the asset. As an example, the initial purchase of electric buses may not meet the test of intergenerational project however it could be debt financed as a strategic initiative. The lifespan of a bus is in the range of 14-16 years and the term of that debt should match this lifespan.

The majority of these projects are cost shared with other orders of government, HRM will only be issuing debt for their portion of the project cost. Debt is taken out once the project has been completed. Given the size of these projects and the duration of the project build it is not anticipated that the debt will be needed until 2024 at the earliest.

It is anticipated that the payment of the principal and interest on the debt for Strategic Initiatives will come from the Principal and Interest Reserve Q631. Starting in 2021/22 staff is recommending that an annual budget allocation occur for strategic reserves. If $10M (2 cents on the tax rate) is placed into the reserve and that a minimum of 75% of that allocation is used to offset the required annual principal and interest payments, then $150M in debt could be issued to support strategic initiatives. See Figure D below for an illustration. The balance of the budget allocation could go in the strategic projects reserve to fund those projects that do not meet the criteria for debt financing, e.g. operating costs and items that cannot be debentured.

Figure D – Estimated Principal and Interest for $150M in Debt for Strategic Initiatives ($M)



<u>Reserves</u>
The purpose of reserves is to safeguard HRM from unforeseen events and to allow HRM to take advantage of opportunities as they occur such as cost shared infrastructure programs. Through COVID HRM has been able to maintain its reserve balances. Rather than go to reserves to offset lost revenues and increased costs, HRM chose to recast its budget and reduce capital and operating spending. This approach has allowed HRM to maintain its steady financial position.

Of interest for the purpose of strategic initiatives are the Strategic Capital Reserve Q606 and the Principal and Interest Reserve Q631 as well as budgeted allocations to these reserves. As indicated previously, Regional Council had dedicated specific funding to the strategic capital reserve for “planned” and “potential” capital projects, mainly the sale of specific lands within HRM and a dedicated one cent on the tax rate to fund these projects through the issuance of debt. The reserve review will consider changes to Q606 and Q631 to allow those reserves to be used for new strategic initiatives, including through the issuance and repayment of debt.

As part of the annual budget process staff would report to Regional Council on the state of the reserves, the projects that have been funded and the long-term plan for the reserves. Any realized savings from projects, such as the electrification of buses and energy retrofits could be allocated to the reserves. Withdrawals from the reserves will be on recommendation of the CFO and CAO.

FINANCIAL IMPLICATIONS

Funding for the strategic reserve and the P&I reserve will form part of the annual budget process. The broadening of the existing reserves to allow for strategic initiatives will improve the long-term fiscal sustainability of HRM. Planned debt increases and a mechanism to pay to the principal and interest costs will provide for stability in taxation. Without a planned approach to financing these projects taxpayers will be subject to spikes in the tax rate in order to move these initiatives forward or the infinitives may simply falter.

Failure to establish a dedicated financing stream for strategic initiatives will result in a further erosion of HRM's existing assets. It has been demonstrated that these large city building initiatives cannot be advanced within the existing capital budget allocation without resulting in deferred maintenance of existing assets.

RISK CONSIDERATION

Risk of establishing a strategic initiatives funding plan are low, this approach can be viewed as a risk mitigation strategy to ensure the fiscal sustainability of HRM and to protect taxpayers from unplanned swings in the tax rate.

COMMUNITY ENGAGEMENT

Each of the strategic initiatives have undergone extensive community engagement as part of the development process as well as the approval process.

In addition to project specific community engagement, as part of the budget process an online survey is conducted through the Shape Your City portal. In that survey residents are asked what services are important to them and where they would like to see their taxes invested. In 2021 HRM will be undertaking a 20 Year Visioning exercise, it is anticipated that additional city building initiatives could be identified at that time.

ENVIRONMENTAL IMPLICATIONS

The strategic initiative funding plan will ensure that HRM has resources when required to advance the objectives of HalifACT2050 as well as other environmentally friendly projects (IMP, MFTP and Rapid Transit). Without a dedicated plan finding for environmental initiatives will have to compete against other capital projects.

ALTERNATIVES

Budget Committee could reject the idea of establishing a strategic initiatives funding plan, this is not recommended for reasons cited in the report. The strategic initiative funding plan is also a component of the Fiscal Sustainability Strategy that Regional Council passed on December 15, 2020.

ATTACHMENTS

N/A

A copy of this report can be obtained online at halifax.ca or by contacting the Office of the Municipal Clerk at 902.490.4210.

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