

Management Discussion & Analysis

Audited Consolidated Financial Statements – December 31, 2019

Another financial year has come to a close for the City of Spruce Grove. This document is designed to provide a management overview of the Audited Consolidated Financial Statements for the year ending December 31, 2019. Section 276 of the Municipal Government Act outlines financial reporting requirements for municipalities. The statements being discussed in this document ensure the City of Spruce Grove meets those requirements. The secondary goal of this document is open and transparent reporting to all stakeholders. Achieving this goal will help stakeholders to increase their trust in the governance decisions of City Council and the financial management of the City. This document is also intended to provide insight into financial condition thus allowing Council to make informed future decisions.

The City is engaged in many relationships that have an impact on financial decisions. The City's closest relationships exist with its tri-municipal region partners, the Town of Stony Plain, and Parkland County. There are joint service agreements and shared commitments to capital projects. One facility that showcases this tri-municipal relationship is the Transalta Tri-Leisure Center; jointly built and operated by the municipalities through a Part IX company. The City's proportionate share of that facility's operation is consolidated in the financial statements being discussed. The City of Spruce Grove Library is also consolidated within these statements.

Roles and Responsibilities

Management bears full responsibility for the preparation of the consolidated financial statements and the integrity, relevance and comparability of the data within the statements. These statements are prepared in accordance with the Canadian Generally Accepted Accounting Principles (GAAP) and standards established by the Public Sector Accounting Board (PSAB) of the Chartered Professional Accountants of Canada. The external audit firm of KPMG LLP is appointed by City Council to express an audit opinion on the financial statements. The Auditors issued an unqualified opinion on these statements; this indicates they had no reason to withhold an audit opinion.

2019 Financial Discussion

The City of Spruce Grove made progress on major capital infrastructure in 2019. Some of the key projects included Storm System Upgrades in Brookwood, work on the Water Main expansion from Century Road to Pioneer Road, Transit System growth in local service, Water Rehab projects, completion of the new portion of the Protective Services facility, and completion of the RCMP facility jointly built with the Town of Stony Plain. The City looks forward to the completion of the renovation portion of the Protective Services facility in 2020. This will integrate the bays from the previous facility into the new facility.

The City of Spruce Grove's financial position has shifted downward from a Net Debt position in 2018 of \$26.4M to a Net Debt position at the close of 2019 of \$28.9M. Being in a Net Debt position implies that future dollars will be required to pay for past decisions. As the Net Debt is less than actual Long-Term Debt, the future dollars required at this time are for debt payments and not for operations.

The actual debt of the municipality is \$42.1M in 2019, up from \$38.4M in 2018. The allowable long-term debt under section 276(2) of the Municipal Government Act for the City of Spruce Grove is \$128.6M. By City policy, the self-imposed debt limit is 50% of the provincial limit, therefore \$64.3M. With the City's 2019 borrowing balance of \$42.1M, it is currently below both of these limits. Actual borrowing represents 32.7% of the provincial limit and 65.5% of the municipal limit. Debt per Capita has increased from \$1,103 in 2018 to \$1,178 in 2019.

The ratio of Financial Assets to Liabilities also reflects the increased Net Debt position. At the close of 2018, the ratio of Financial Assets to Liabilities was .74. This ratio has declined to .67 in 2019. This means that for every dollar of overall liabilities, the City currently has sixty-seven cents available for repayment of the liabilities. If Long-Term Debt were taken out of this ratio, the City would have \$1.20 for every dollar of liabilities in 2018 and \$1.28 for every dollar of liabilities in 2019. This reflects that currently available assets are still able to cover current liabilities and future dollars are only required for debt repayment, which is to be expected.

The Accumulated Surplus of the municipality is \$516M of which investment in Tangible Capital Assets represents \$502M; the cash surplus position of the municipality is therefore \$13.8M or 2.7% of overall surplus. The cash surplus position has increased from 2018 to 2019. This is still of some concern because the amount of cash position recommended for cash flow management and emergency preparedness is two to three months of expenses. For the city, the recommended amount would therefore be between \$16-24M. With the current \$14M cash surplus position, the city is short of this recommended position by \$2-10M at the close of 2019. The cash surplus position of \$14M is made up of a municipal surplus of \$21M, a utility surplus of \$8M and a developer deficit of \$15M. By city policy, the municipal surplus is to be 20% of expenses. The expenses for 2019 were \$94.6M. The municipal surplus should therefore be \$18.9M. It is currently \$21M which represents 22% of expenses and is therefore currently meeting the policy directive.

Operating results in 2019 show an excess of expenses over revenues of \$8M before other capital items of \$30.7M, resulting in an overall annual surplus of \$22.7M. This surplus is due in large part to Contributed Tangible Assets of \$11.6M and Government Transfers for Capital of \$19.9M. The overall annual surplus is \$7.2M short of the budgeted surplus of \$30M. The following comments are relevant to this discussion:

- Revenue was short of budget by \$2.6M due to a few items. There was a shortfall of fines and permit revenue - due to the unpredictable nature of these revenues, as they are dependent on the number of infractions. Development permits were down due to a slowdown in economic activity. Sales and user fees were also lower than anticipated as the implementation of the new storm utility rate was delayed to September 1st, 2020 and water sales came in under budget as the volume consumed was lower than anticipated.
- Budget savings in all expense line items represented can be primarily attributed to cost deferrals and reductions undertaken in 2019 during corporate planning.
- Contributed Tangible Capital Assets came in less than budgeted, as did Developer Contributions and Levies, some of which was representative of a slow-down in developer activity in the community.
- Due to the timing of capital projects, the amount of Government Transfers – Capital accessed in the 2019 year also came in under budget.

Overall revenue per capita in 2019 increased from \$2,319 to \$2,420. Included in this revenue was property taxes; the per capita for property taxes increased from \$1,061 to \$1,129. Expenses per capita in 2019 increased from \$2,597 to \$2,645. Expenses per capita exceeded revenues per capita, hence the deficit from operations before other capital items.

Looking Forward

Council priorities for 2020 – 2022 called for Sustainable Growth. To accomplish this, Council called for the establishment of a fiscal sustainability framework to ensure prudent and sustainable growth. This will develop a reliable foundation upon which the city can establish its long-term financial planning. The City has also undertaken a Reframe 2020 exercise that is intended to serve as a springboard to set strategic priorities, bring greater clarity to service delivery, and ensure value for money for citizens. This exercise has initially resulted in a pause on capital spending and a review of operational spending, amongst other priorities. This will also help to prepare the City for sustainable growth.

As 2020 unfolds however, the realities created by the COVID-19 pandemic have resulted in a further pause related to spending and measures that are intended to provide financial relief for citizens. The City is deferring the application of penalties on outstanding utility accounts and providing a process for residents to seek deferral of tax penalties if they have been financially impacted by COVID-19. Council also elected to forego the 3.9% tax increase previously approved in budget and elected to reduce this impact to 0%. A new Storm Utility intending to be implemented for April 1 is also being delayed to September 1 to alleviate financial pressure. These COVID-19 decisions will likely require the City to undertake some short-term borrowing for cash flow support. This reality effectively demonstrates the ongoing need for the City to build a healthy municipal fund through future policy decisions.

Past policy decisions positioned the City to become reliant on debt and reduced reserves for future spending. In the past, the City paid for development of key infrastructure in advance of development revenue generation in order to encourage growth. These decisions and practices enabled the City to advance its infrastructure and prepare for future growth but also left the City in an accumulated surplus position that is not optimal for ongoing operation and therefore is not sustainable long-term. The City is now entering into a time where it can slow its capital spending and also allow development to catch up to the infrastructure already provided. The City will need to rebuild a municipal fund that is healthy enough to carry two to three months of expenses and to help to provide for some future capital spending. The City will also need to continue to develop its asset management information, thus paving the way for robust long-term capital planning and evidence based decision making.

The City has been working hard to advance financial literacy for all its decision makers and continually assess its financial condition. This is expected to continue with Council through quarterly reporting and annual updates. The development of a sustainable fiscal policy framework will aid decision making and will contribute to sustainable financial health for the City in the future.

Louise Frostad

Chief Financial Officer

April 16, 2020