Newmarket

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December 11, 2015

JOINT CAO, COMMISSIONERS AND CORPORATE SERVICES REPORT FINANCIAL SERVICES - 2015-63

TO: Mayor Tony Van Bynen and Members of Council
Committee of the Whole

SUBJECT: 2016 Capital Budget

ORIGIN: Director, Financial Services/Treasurer

RECOMMENDATIONS:

THAT Joint CAO, Commissioners and Corporate Services Report - Financial Services – 2015-63 dated December 11, 2015 regarding the 2016 Capital Budget be received and the following recommendations be adopted:

1. **THAT the 2016 Draft Capital Budget, subject to any direction from Committee, be presented to Committee of the Whole on January 11, 2016 for final review and recommendation to Council;**
2. **AND THAT the amount of the Infrastructure Levy for 2016 be determined and presented to Committee of the Whole on January 11, 2016 for final review and recommendation to Council.**

COMMENTS

Purpose
The purpose of this report is to obtain Committee direction on any revisions to be made to the draft capital budget and on the amount of the infrastructure levy, so that Committee of the Whole on January 11, 2016, can have a final review and make a recommendation to Council.

Budget Impact
The current draft capital budget proposes $28,082,224 in expenditures. The funding has already been accounted for in the current and previous operating budgets.

The amount of the infrastructure levy – additional Asset Replacement Funds (ARF) contributions – has yet to be determined

Summary
This report provides information for Council to review the ARF funding of the capital budget for 2016, and for future budgets through the infrastructure levy.

BACKGROUND - Schedule

Special Committee of the Whole meetings were set for December 7 and 14. The intent of these meetings is to allow for Committee deliberation on issues identified at the November 16 meeting, and to prepare for a final budget recommendation to be made on January 11 with approval on January 18.

The issues identified were:

- New staffing requests – direction was provided on December 7
- Central York Fire Services governance – report provided on December 7
- Capital Program funding from the Asset Replacement Fund – to be addressed in this report and a presentation at the December 14 meeting

The inclusion and amount of an infrastructure levy, to increase contributions to the Asset Replacement Fund, has yet to be determined and is considered in this report.

ACTIVITY	DATE	STATUS
Special Council – Approval of Fees & Charges	November 30	Completed
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Pending Budget Revisions

On November 16, the preliminary draft budget proposed expenditures of $27,152,224.

Two additions to the 2016 capital budget were proposed at the Committee of the Whole meeting of November 30:

- Trail from Yonge Street to Rita's Avenue - Joint Development & Infrastructure Services/Planning and Building Services/Engineering Services Report 2015-44 requested that additional funding of $630,000 be added to 2016 capital budget, and that the remaining 2014 budget of $304,399 be cancelled. This cancellation will impact the capital carryforwards at the end of 2015, but has no direct impact on the new requests for 2016. This project has been categorized as growth, funded by reserves - Priority 3.
- Magna Centre renovation re: fitness centre – Community Services Report – Recreation and Culture Committee of the Whole Report 2015-37 included a suggestion to add $300,000 to the 2016 Capital Budget. This project has been categorized as growth, funded by Development Charges ($250,000) and an internal loan repayable from future revenues ($50,000) – Priority 3.

If Council approval is given on December 14, the draft budget will be revised to include expenditures of $28,082,224.

The capital budget provides infrastructure to deliver municipal services.

The capital budget differs from the operating budget in that the expenditures are for items that will provide benefits beyond the year in which they are incurred. The infrastructure or capital assets will support service for many years – even for decades. In private business, this is recognized by applying depreciation expenses against the revenues of future years.

As the primary purpose is to support service delivery, capital expenditures are categorized accordingly. This was one of the recommendations of the Capital Financing Sustainability Strategy. The components are:

1. Replacement – maintaining service levels for the existing population - with a focus on condition.
2. Growth – maintaining these same service levels for a growing population, usually related to development – with a focus on per capita investment.
3. Other – increasing the service level either by choice, enhancement or if required by legislation; such as a health or safety requirement.

In this context, there are two factors for determining service level:

1. Investment per capita – the current replacement value of our capital assets divided by the Town's population. This is the factor required for Development Charges.
2. Condition – a theoretical measure of the asset's ability to provide the desired service on a scale of 0-100%. This can also be adjusted by the risk of failure.

In addition, capital requests are prioritized for administrative purposes:

1. Legislative requirement, health and safety
2. Replacement
3. Other

This scale does not reflect Community or Council priorities: the budget process provides the opportunity to do so.

The growth component of the capital budget maintains service levels for a growing population.

$13,267,500 of the proposed capital budget consists of projects in the growth category. By definition, most of these fit into Priority 3. As over 80% of this is funded from Development Charges (DC's) – including $3 million from Aurora, there is limited savings from deferring or eliminating any of these projects. In fact, doing so could reduce the defined service levels and restrict our ability to collect DC's in the future.
The potential flexibility in this area was addressed by Corporate Services Information Report – Financial Services 2015-26, Development Charges and Capital Budgets.

The main project is the purchase of land and the construction of a 5th fire station. $7.5 million is included in the 2016 budget and a further $2.5 million would be the 2nd phase in 2017. The budget includes 40% funding from the Town of Aurora, our partner in the joint service Central York Fire Services (CYFS).

The "other" portion of the capital budget consists of investments that increase service levels.

As previously mentioned, service levels may be increased by choice, enhancement or be required by legislation. In either case, the per capita investment is increased. In simple terms, anything that does not fit in either the replacement or growth category is "other" by default. A project which has a growth or replacement component may be included as "other" based on the proportion.

The sources of funding are dedicated reserve funds, grants, partnerships, non-tax operating funds (water and/or wastewater). Where such funding is not available, general is used. General is funded from the tax-supported operating budget supplemented by general capital reserves. The 2016 request is within the funding envelope and does not require the use of general reserves.

GENERAL	
Opening reserve balances	$2,246,662
Capital budget - other	(443,150)
Capital budget - growth	(15,550)
Capital budget - replacement	(41,300)
2016 contributions	500,000
Closing reserve balances	**$2,246,662**

The replacement section of the capital budget consists of investments to maintain existing service levels.

83.5% of the funding for this section is from the Asset Replacement Fund (ARF) and 16% from the Gas Tax which is as an ARF supplement and applied to Roads. As to be expected, most of these projects are Priority 2. The main programs in 2016 are:

REPLACEMENT PROGRAM	
Bridges and culverts	$ 760,000
Engineering Design	700,000
Facilities	846,800
Fire Services	2,010,000
Information Technology	671,524
Library	175,700
Parks	292,350
Public Works Equipment	929,500
Roads	6,050,000
Stormwater Management	450,000
Water and Wastewater	100,000
TOTAL	**$12,985,874**

There has been some concern expressed that the level of expenditures is not allowing for any growth in the Asset Replacement Fund.

The amount of the funding envelope is dependent upon the option selected for the Infrastructure Levy. The increase for the rate-supported ARF has been presented and recommended as part of the water and wastewater budgets and their 6-year financial plans. Some ARF is used in the operating budgets for major maintenance, condition assessments and debt servicing – the increases are covered by decision packages.

	0.80% ARF Levy	1.00% ARF Levy
Opening reserve fund balances	$ 3,530,379	$ 3,530,379
2016 contributions	15,046,430	15,046,430
2016 increase – tax-supported	424,583	530,729
2016 increase – rate-supported	488,395	488,395
2016 maintenance and condition assessments	(5,650,784)	(5,650,784)
TOTAL	**$ 13,839,003**	**$ 13,945,149**

Committee may decide to:

A. Not reduce the program
B. Reduce the program to the extent necessary to maintain the existing ARF balance
C. Reduce the program to the extent necessary to increase the existing ARF balance by the amount of the tax-supported levy.
D. Reduce the program by $1.6 million
E. Other options

Options with 0.80% ARF Levy

	A	B	C	D
Funding envelope	$ 13,839,003	$ 13,839,003	$ 13,839,003	$ 13,839,003
2016 capital requirements	(11,023,074)	(11,023,074)	(11,023,074)	(11,023,074)
Further reductions	0	714,450	1,139,033	1,600,000
Closing reserve fund balances	**$ 2,815,929**	**$ 3,530,379**	**$ 3,954,962**	**$ 4,415,929**
Net change in reserve fund balance	**($ 714,450)**	**0**	**$ 424,583**	**$ 885,550**

Options with 1.00% ARF Levy

	A	B	C	D
Funding envelope	$ 13,945,149	$ 13,945,149	$ 13,945,149	$ 13,945,149
2016 capital requirements	(11,023,074)	(11,023,074)	(11,023,074)	(11,023,074)
Further reductions	0	608,304	1,139,033	1,600,000
Closing reserve fund balances	**$ 2,922,075**	**$ 3,530,379**	**$ 4,061,108**	**$ 4,522,075**
Net change in reserve fund balance	**($ 608,304)**	**0**	**$ 530,729**	**$ 991,696**

Any reductions to the replacement program would normally be deferrals with the lifespan of the infrastructure being extended. The following should be considered:

1. Possibility of increased operating/maintenance costs
2. Possibility of a lower service level due to declining condition
3. Increased risk of failure

If a reduction is required, Engineering staff have determined that the roads program would be their choice for deferral to minimize the overall impact.

Capital projects involving road reconstruction and resurfacing need to be closely coordinated with planned infrastructure works below grade in order to sequence the necessary work in a logical way. This includes assessing the water and sewer capital program to determine where upcoming improvements are planned and dovetailing the roads program to follow, with improvements on those streets. Similarly, road reconstruction and resurfacing programs need to consider planned work of other utilities; the Region of York, vivaNext and other Town of Newmarket projects, in order to minimize the level of simultaneous disruption to users of the road network.

For 2016, the coordinated capital program for road reconstruction has taken into account the water/sewer and utility upgrades needed, and will be deferring some work into 2017 and beyond in order to efficiently manage and sequence the works required on Town roads. The coordination has also taken into account the Region's capital road improvement program. This includes on-going rapid transit work in the Davis Drive and Yonge Street corridors so that parallel routes are not disrupted by construction at the same time, or to the greatest extent possible, this is minimized.

Deferral of some of the 2016 Roads infrastructure program will enable the Engineering department to focus on design work for roads that are anticipated to be reconstructed beyond 2016. This will enhance future capital delivery rates and should result in earlier tenders within a calendar year for contracted work to secure beneficial pricing for the Town. By advancing the design work on future year's projects, this will also enable the Town to have projects that are "shovel-ready" and quickly delivered to take advantage of potential Federal-Provincial Infrastructure funding programs that often are limited-time opportunities.

Increases in Asset Replacement Fund contributions will be required to offset the infrastructure deficit.

There is no commonly accepted means to measure the infrastructure deficit. This is because it is not based on today, but a projection of tomorrow.

One metric is capital reserves as a % of accumulated amortization - this is a measure of how much. A standard business practice is to recover the cost of capital assets (amortization aka depreciation) through revenues - as such, the target should be 100%.

Based on our 2014 financial statements, the Town has set aside $6.32 for every $100 of amortization - we are slowly improving. The annual contribution to the ARF was 85.1% of the tax-supported amortization, and 94.1% on the rate-supported.

Another aspect is to project the critical years. For taxes, the critical decade starts in 2025 (Hemson's calculations for the Capital Financing Sustainability Strategy). For water and wastewater, it is the 2060's (2015 update to the 6-Year Water and Wastewater Financial Plans).

There have been some sustainability measures taken by the Town:

- Water and Wastewater has been made fully sustainable in the updated Financial Plans – which were based on a projection that extended out 50 years.
- Central York Fire Services updated their ARF contributions in 2013 based on 10-year capital projections.
- Newmarket Public Library has been directed by their Board to undertake an analysis of projected ARF requirements.
- In 2014, Hemson Consulting presented the Capital Financing Sustainability Strategy which projected capital funding requirements and made a number of recommendations.

One of Hemson's recommendations was the creation of an infrastructure levy. Although the Town has been contributing to the Asset Replacement Fund since 1998, the amounts being contributed in today's dollars are insufficient. The recommended levy increase was:

- an annual tax increase of 1.08%, or
- an annual tax increase of 0.85% if a stormwater management rate is implemented

As a result, the following levies have been approved by Council:

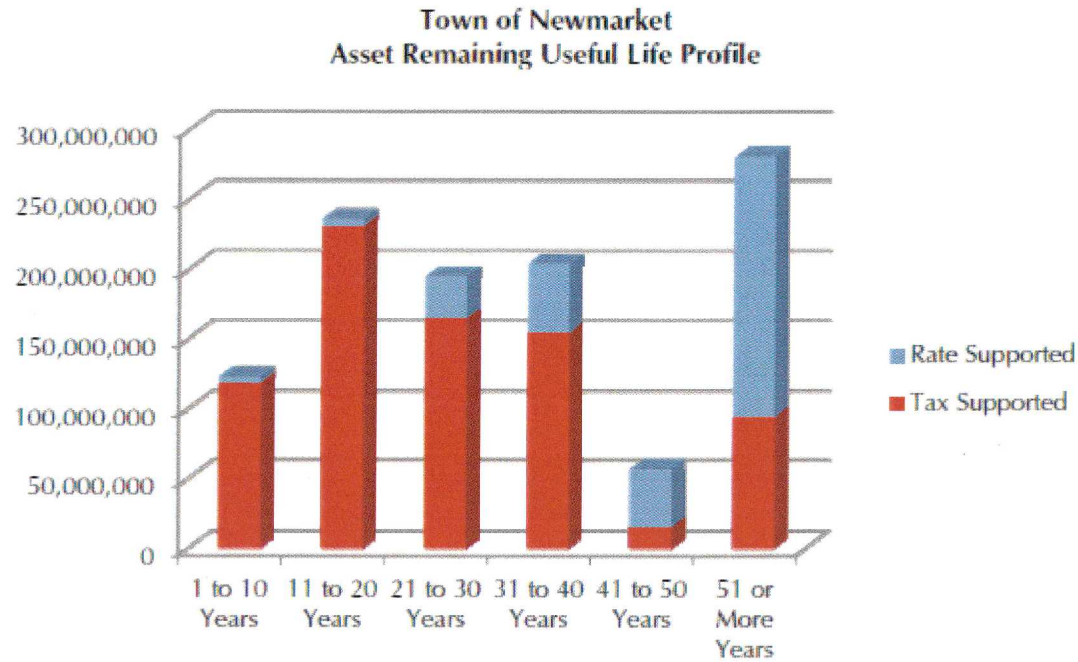
- 2013 0.80% ($363,773)
- 2014 0.74% ($358,125)
- 2015 1.00% ($505,127)

Under consideration for 2016 is 0.80% ($424,583) or 1.00% ($530,729).

Significant investment in infrastructure will continue to be required.

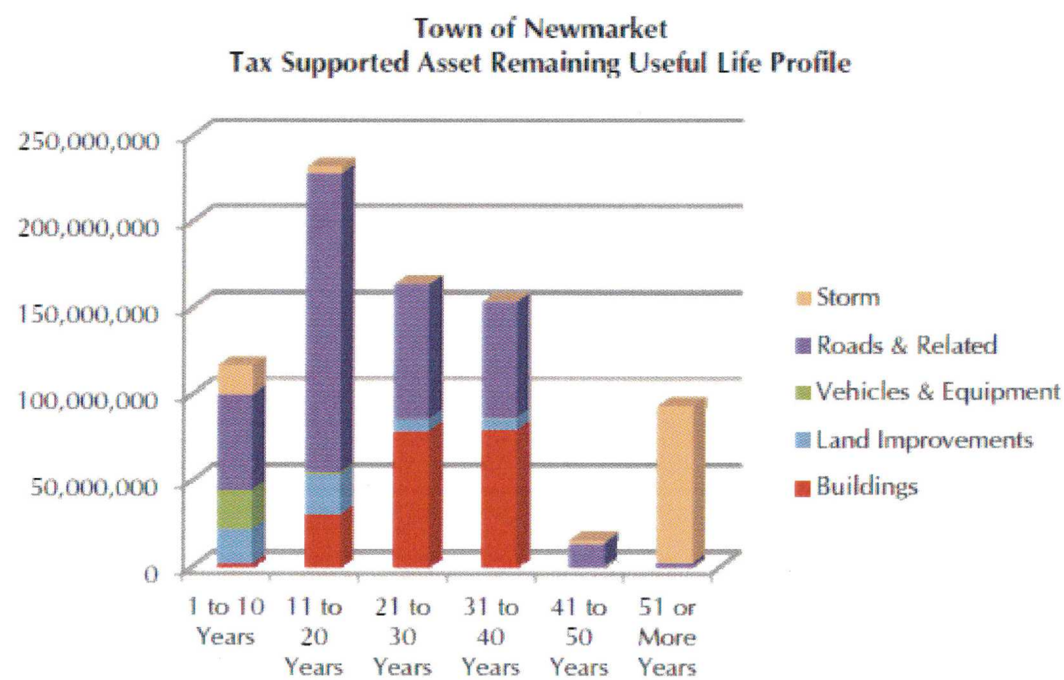
The following chart is from Hemson Consulting's Capital Financing Sustainability Strategy - Part 2 report, which was issued in March of 2014 and outlines these items:

- replacement requirements vary significantly over time
- our current requirements are lower than what we can expect in the next 10 to 40 years
- rate-supported requirements are relatively low for the next 40 years, but then escalate



Source: Hemson based on Town ARF data

The next graph segregates the tax-supported requirements by asset class.



Source: Hemson based on Town ARF data

The proposed capital program aligns with the Sustainable Financial Strategy.

With regards to the elements of the Sustainable Financial Strategy:

- Reserves and reserve funds
  - General capital reserves are preserved for future use
  - Consideration is given to the Asset Replacement Fund balance
  - Polices for Reserves and Reserve Funds, and for the Asset Replacement Fund, will be presented early in 2016
- Debt
  - No new external debt is being contemplated with this budget
  - A small internal debt is required which should be repayable within 4 years.
  - Debt Policy will be updated early in 2016
- Asset Management
  - The Asset Management Plan (AMP)
  - Asset Management Policy will be presented early in 2016
  - Further work will include the refinement of service levels
- Investment Strategy
  - A small internal debt is required which should be repayable within 4 years.
  - The repayment schedule will in accordance with the Investment Strategy
  - Investment Policy and Strategy will be updated early in 2016
- Revenues
  - Not applicable to the 2016 Capital Budget

NEXT STEPS

ACTIVITY	DATE	STATUS
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BUSINESS PLAN AND STRATEGIC PLAN LINKAGES

This report links to Newmarket's key strategic directions in being Well Managed through fiscal responsibility.

CONSULTATION

The 2016 budget was a collaboration of all management staff and saw the Operational Leadership Team (OLT) taking on a greater role.

This report was prepared by the Treasurer in consultation with the Strategic Leadership Team (SLT).

HUMAN RESOURCE CONSIDERATIONS

Not applicable to this report.

BUDGET IMPACT

The current draft capital budget proposes $28,082,224 in expenditures. The funding has already been accounted for in the current and previous operating budgets.

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CONTACT

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