

REGULAR COUNCIL

TO: **Mayor & Council**

DATE: **May 23, 2024**

FROM: **General Manager, Finance**

FILE: **1880-20**

SUBJECT: **Quarterly Financial Report - First Quarter - 2024**

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 2024 and to compare this activity relative to the 2024 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, followed by an outline of Surrey's financial performance through the first quarter of 2024, in comparison to the adopted Five-Year (2024-2028) Financial Plan.

Economic Environment and Key Economic Factors

International Overview

The International Monetary Fund ("IMF") provided an updated economic outlook in April of this year. The global economy is forecasted to grow by 3.2%, a slight upward revision of 0.1% from January's prediction. For 2024, the IMF forecasts the United States ("US") economy advancing by 2.7%, China growing by 4.6%, and a slower expansion of 1.2% and 0.8% for Canada and the Eurozone, respectively. The fund forecasts the United Kingdom's ("UK") economy to lag behind with subdued growth of 0.5% this year.

Economic activity has been resilient over the past two years despite persistent inflation and high interest rates. Despite a challenging economic environment, the global economy did not fall into recession. This is due to households and the major advanced economies' ability to draw on substantial savings that were accumulated during the pandemic.

The IMF is projecting global inflation to fall to an annual average of 5.9% this year and 4.5% next year, with central banks in advanced economies returning to their inflation targets earlier than developing economies. The IMF cautions that the global economy could be facing new price hikes due to ongoing geopolitical tensions in the Middle East and the war in Ukraine. The IMF expects economic growth to be muted in the next two years due to elevated borrowing costs and withdrawal of fiscal supports by governments.

Most major central banks around the world have signalled that interest rates have peaked, with inflation starting to normalize and return to targeted levels, creating conditions which would warrant serious consideration toward interest rate cuts this year. The rate of descent for policy rate reductions by central banks will not match the swift and aggressive pace that was employed for rate hikes over the last two years. Central banks are expected to cut interest rates in smaller increments with periodic pauses to monitor the effects of adjustments to their monetary policies. The era of ultra-low interest rates is over; economists expect interest rates to settle at a higher level for the coming years. The IMF cautions that central banks need to ensure that interest rates are not eased too prematurely to avoid rekindling inflation, nor delayed too long, thereby causing damage to economies and triggering a recession.

United States Overview

The US Federal Reserve (“Fed”) kept its benchmark interest rate range at 5.25% - 5.50% for the sixth consecutive meeting in May. Policy makers at the central bank expressed concerns that inflation is still persistently high and not moving substantially towards their 2.0% target. US inflation came in at 3.4% in April. Core inflation, which strips out volatile items such as food and various fuels, remains elevated at 3.6%. Although the central bank is concerned about the current inflation level, it is still expected to cut interest rates this year, with reductions contingent on inflation moving in the right direction.

US economic growth slowed in the first quarter of the year with annualized Gross Domestic Product (“GDP”) coming in at 1.6%, below economists’ expectation of 2.4%. Based on the recent Consumer Price Index (“CPI”) and GDP announcements, analysts are readjusting their expectations on the timing and frequency of Fed interest rate cuts. Prior to the data releases, analysts had priced in three to four interest rate cuts this year starting in June. Analysts now only expect one to two rate cuts in the last quarter of the year.

The US labour market is showing resiliency despite high interest and inflation rates with 303,000 jobs added in March. The unemployment rate edged lower to 3.8%, down 0.1% from prior month. The March average hourly wage rate rose by 4.1% from the prior year. The largest advances were seen in the healthcare, government, construction, leisure, and hospitality sectors. Despite inflationary pressures, US consumer spending remains strong, fueled by a strong labour market and rising wages. Retail sales rose by 0.7% in March, almost doubling economists’ estimates. The deceleration in the economy will eventually lead to lower demand for labour and put downward pressure on wages and help rein in consumption. Fed policy makers voiced concerns that higher borrowing costs are not having the desired impacts on consumer spending. US households tend to hold mortgages that have longer fixed terms, and many took advantage of low rates during the pandemic and refinanced mortgages at lower rates. It is estimated that, on average, Americans are spending 9.8% of their after-tax income on debt servicing costs.

The US dollar has appreciated over the last year. The US dollar index, which measures the value of the currency, appreciated 14.0% in April compared to the same month last year. The strong US economy, coupled with a strong labour market and sticky inflation, is expected to keep Fed rates on hold for longer. As a result, the US dollar index will continue to appreciate as other central banks begin their rate cuts in advance of the Fed. The divergent interest rates between the US and other central banks will drive up US dollar demand.

Canadian Overview

The Bank of Canada (“BOC”) held its key interest rate at 5.0% at the April meeting. The central bank has acknowledged that it is seeing the conditions necessary to contemplate interest rate cuts this year. However, bond yields have recently ticked upwards due to surprisingly strong economic data in the US. Accordingly, economists have scaled back their BOC rate-cut predictions for 2024 from three reductions down to two, with tepid expectations for a 50-basis point reduction this year, and a full 1.00% rate decline not forecasted until December 2025. The BOC chair stated that as long as inflation continues to trend downward, an interest rate cut during the June meeting is a possibility but cautioned that rate reductions are conditional on the path taken by inflation. The central bank is forecasting inflation to remain at 3.0% during the first half of the year, falling to 2.5% in the last half of the year, and finally returning to 2.0% by the end of next year. The economy is forecasted to grow by 1.5% this year and 2.0% the following year.

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. In April, Canada’s unemployment rate came in at 6.1% with 90,000 new jobs added. The central bank had stated that wage growth needs to slow, and the unemployment rate rise, to effectively drive down inflation. The central bank cautions that tight labour market conditions and sustained increases in wage growth of four to five percent will make it difficult for inflation to return to its 2.0% target. In April, the average hourly wage went up to \$34.95, a 4.7% increase from the prior year.

Canada’s inflation came in at 2.9% in March, up 0.1% from prior month. Excluding gasoline prices, inflation actually went down month-over-month. There is continued upward pressure on housing costs, measured and reported by Statistics Canada as “shelter inflation”. In March, shelter inflation came in at 6.5% compared to the prior year, rent was up 8.5%, and mortgage interest increased 25.4% year-over-year. According to a recent Royal Bank of Canada survey, six in ten Canadian mortgages with major banks will be up for renewal in the next three years. Over the next two years, 2.2 million mortgage holders will be bracing for renewals at a much higher interest rate, resulting in significant increases to mortgage payments.

The Federal government introduced the budget for 2024, proposing \$52.0 billion in new spending over the next five years. The budget has higher spending, higher deficits and higher taxes targeting individuals and corporations. The government is forecasting budget deficits for the next five years with the current year deficit estimated to be \$40.0 billion. High interest rates are affecting government finances as well with the federal budget projecting 10% of 2024 revenues to go towards debt servicing.

The Canadian government made housing a major focus with \$8.5 billion earmarked for housing initiatives. The Canada Student Financial Assistance program will have more support for students. The formula to calculate financial support under this program will factor in higher housing costs. The federal government is planning to expand student grants and interest-free loans which is

estimated to cost \$1.1 billion this year. Small and medium-sized businesses will see Carbon Tax rebates which had previously been promised to offset the tax's economic costs. The rebate is estimated to cost \$2.5 billion and benefit 600,000 small businesses with 499 or fewer employees.

To help fund the increased spending, the government is planning to increase the capital gains inclusion rate from 50.0% to 66.7% for all capital gains beyond \$250,000 in a given year. The government is estimating the change in capital gains tax will bring in revenues of more than \$19.0 billion over the next five years. Other measures that were announced included a minimum tax of 15.0% to be applied to the profits of large multi-national corporations and increased taxes on nicotine products.

British Columbia Overview

The British Columbia ("BC") economy is forecasted to slow in 2024 with GDP growth estimated at 0.9% this year. The provincial unemployment rate came in below the national average at 5.5% with 6,600 jobs added in March. The unemployment rate rose by 0.3% from the prior month. The province also reported the highest average hourly wage rate of \$36.50 among all provinces.

Inflation, high interest rates, and housing costs continue to weigh down the economy. Elevated interest rates impact British Columbians more than other provinces due to higher house prices in BC, leading to greater mortgage servicing costs in the years to come. As inflation trends towards the BOC's targeted range, interest rates will eventually start to decline. However, rates are not expected to return to the historically low levels that consumers and businesses have been accustomed to. Renters also feel the impact of higher interest rates as landlords trickle down their increased costs to tenants. The BC government has capped allowable rent increases to 3.5% in 2024, marking the second consecutive year where the allowable rent increase is lower than the inflation rate.

The BC government announced that, starting June 1st of this year, the minimum wage will increase from \$16.75 to \$17.40 per hour. The 3.9% increase is based on the average rate of inflation in 2023. The government has amended legislation so that future minimum wage rate increases are automatically pegged to the prior year's average rate of inflation.

The provincial government tabled its budget in February, projecting a deficit of \$7.9 billion due to increased spending and a forecasted slow down in the economy. BC's debt is projected to come in at \$71.9 billion this year, climbing to \$126.5 billion over the next three years. Capital spending over that same time period to support healthcare facilities, housing, schools, and roads is expected to cost \$43.3 billion.

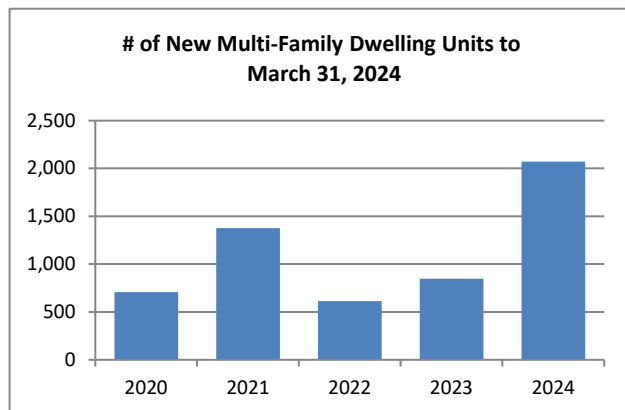
To support renters, the government introduced the BC renter's tax credit which will provide up to \$400 in income tested tax credits to eligible renters. The budget also included an expansion of the BC Family Benefit, a one-time Electricity Affordability Credit, and an enhanced Climate Action Tax Credit. The province is projecting that the average family will receive a \$445 increase in benefits. BC Hydro customers will get a \$100 rebate. Small businesses will see support from the government as the Employer Health Tax ("EHT") exemption threshold was raised from \$500,000 to \$1.0 million. Businesses with payrolls under this threshold will be exempt from paying this tax. The provincial Finance Minister stated that she expects 90.0% of businesses in the province to now be exempt from the EHT.

City of Surrey Overview

In Q1 2024, the City experienced a surge in the issuance of building permits, resulting in significant increases in values of construction related to the multi-family residential and Industrial, Commercial & Institutional (“ICI”) development segments, substantially surpassing figures from previous years. This increase can be directly attributed to the implementation of the new Metro Vancouver Water Development Cost Charge (“DCC”) which took effect in April 2023. On April 27, 2024 the one-year rate protection period for in-stream projects expired, resulting in developers advancing their project timelines to mitigate the financial impact of the Metro Vancouver DCC rate change on their projects. This drove the increased volume of permits issued by the City in quarter one of this year. The phenomenon of developers advancing their development schedules in response to negative financial consequences related to upcoming legislative changes is not unprecedented.

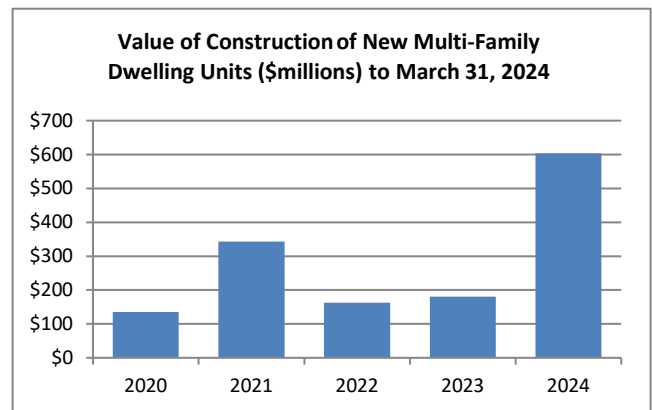
City of Surrey’s Key Performance Indicators

The following graphs show data for the first three months of 2024 compared to previous years.



Graph 1

As discussed above, there has been an overall increase in development activity in multi-family residential projects in early 2024. This quarter has seen an increase in permits for multi-family dwelling units by 144%.



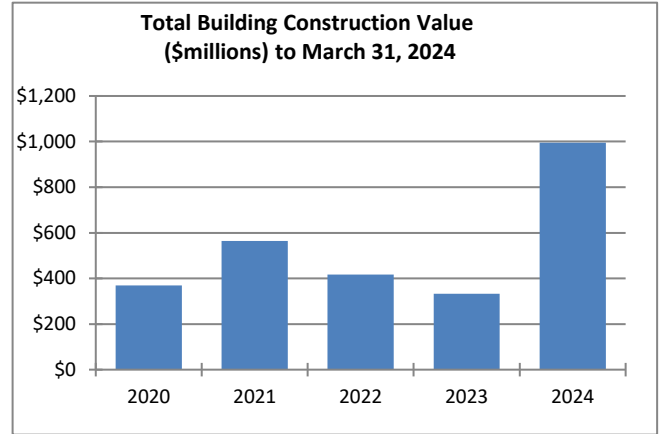
Graph 2

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 234% when compared to the same period last year.



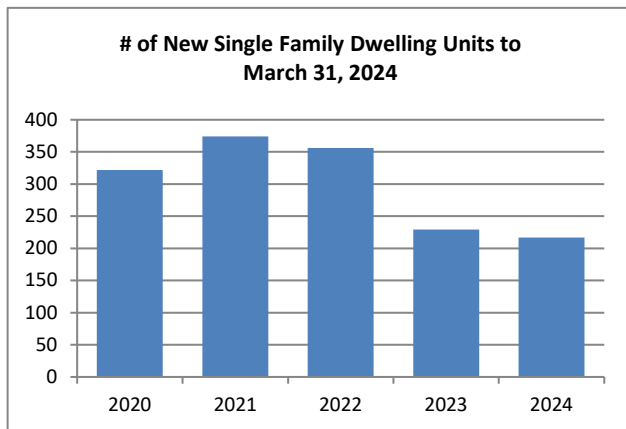
Graph 3

Construction value of ICI permits for the first three months of 2024 is higher by 386% as compared to the same period in 2023. This is primarily due to some significant projects that received permits in the first quarter of 2024, including two large industrial warehouse projects in Campbell Heights and a large mixed-use office/commercial high-rise tower in City Centre.



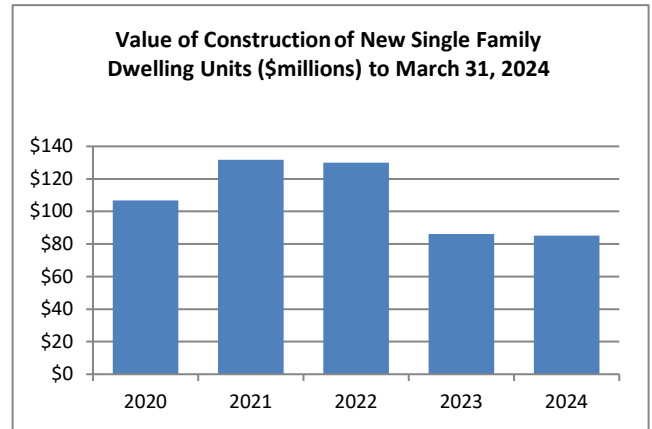
Graph 4

Due to an increase in the construction values associated with multi-family residential permits, along with increases in values of construction associated with ICI projects, the total building construction value in the City year-to-date is higher by 199% compared to the same period last year.



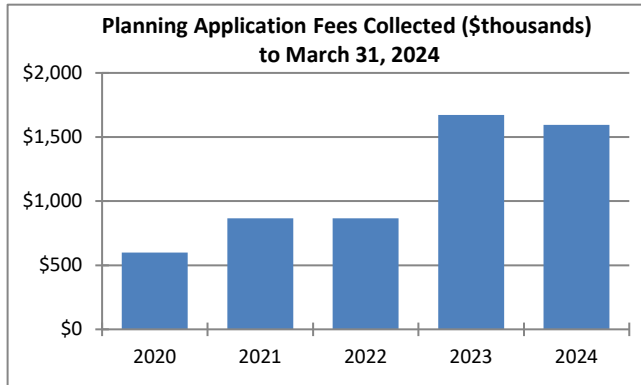
Graph 5

Due to a continued shift in residential development activity from single-family to multi-family, new Single Family Dwelling units have declined by 5% in this quarter, as compared to the same quarter in 2023.



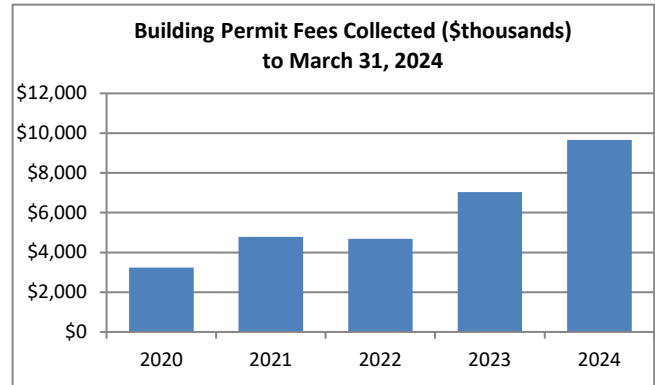
Graph 6

Due to a decline in the number of new single-family dwelling unit permits issued in this quarter as compared to the same period last year, the value of construction of these units has correspondingly decreased by 1% when compared to the same period last year.



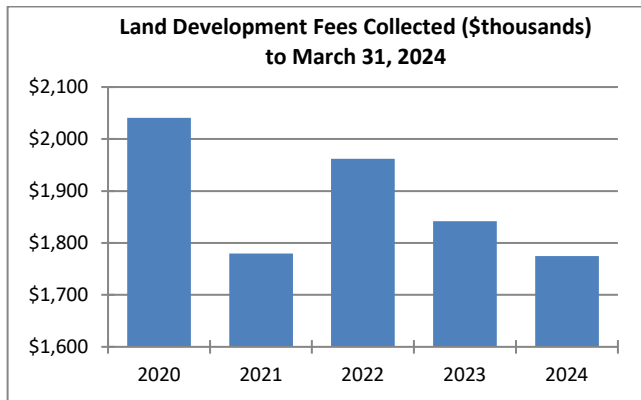
Graph 7

Due to headwinds in the real estate sector resulting from the uncertain timing of Bank of Canada key interest rate reductions; overall planning activity for future development projects within the City has declined slightly, coming in 5% lower as compared to the same period last year. Despite the slight decline, planning application fee collections in this quarter are higher than the average of the first three months of the four prior years.



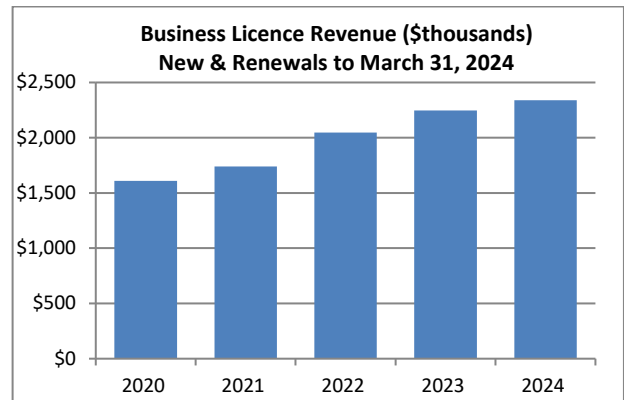
Graph 8

Due to significant increases in total values of construction, building permit fees collected in the first three months of the year remained strong, resulting in a 37% increase as compared to those collected in the same period last year.



Graph 9

In alignment with Planning Application fees, Land Development fees collected for the first three months of 2024 are lower by 4% as compared to the same period in 2023.

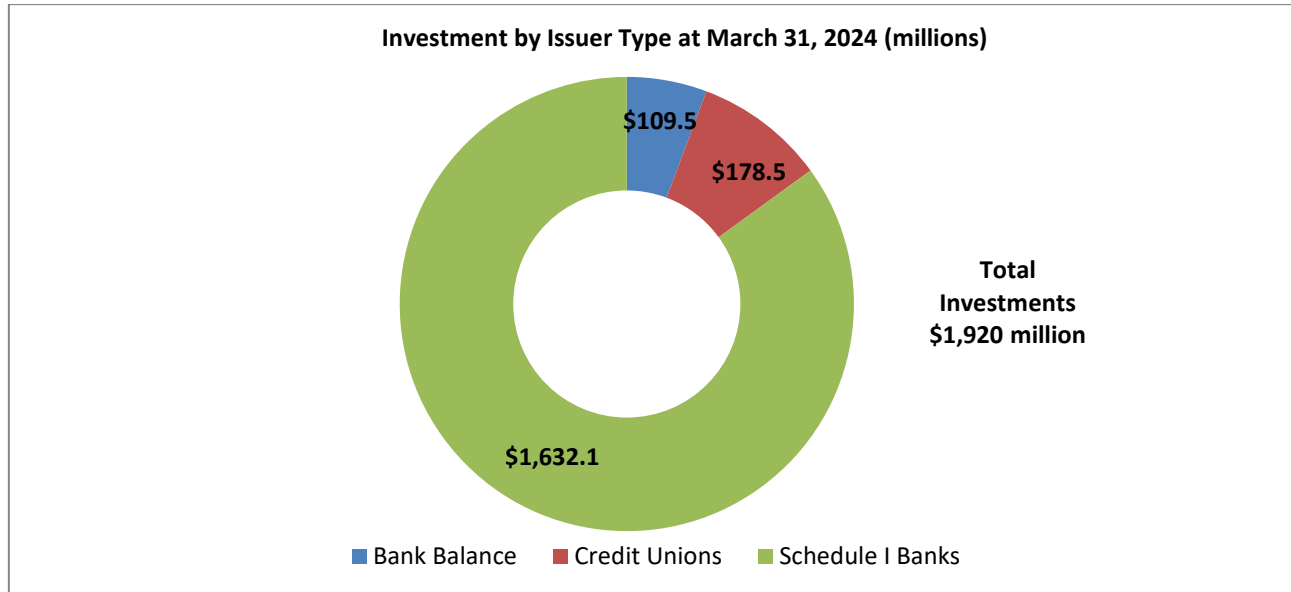


Graph 10

Consistent with first quarter increases in the last few years, business licence revenue in the first three months of 2024 increased by 4% as compared to the same period last year. This is indicative of ongoing confidence expressed by the business community, which continues to expand their enterprises in Surrey.

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 \$1,920 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.

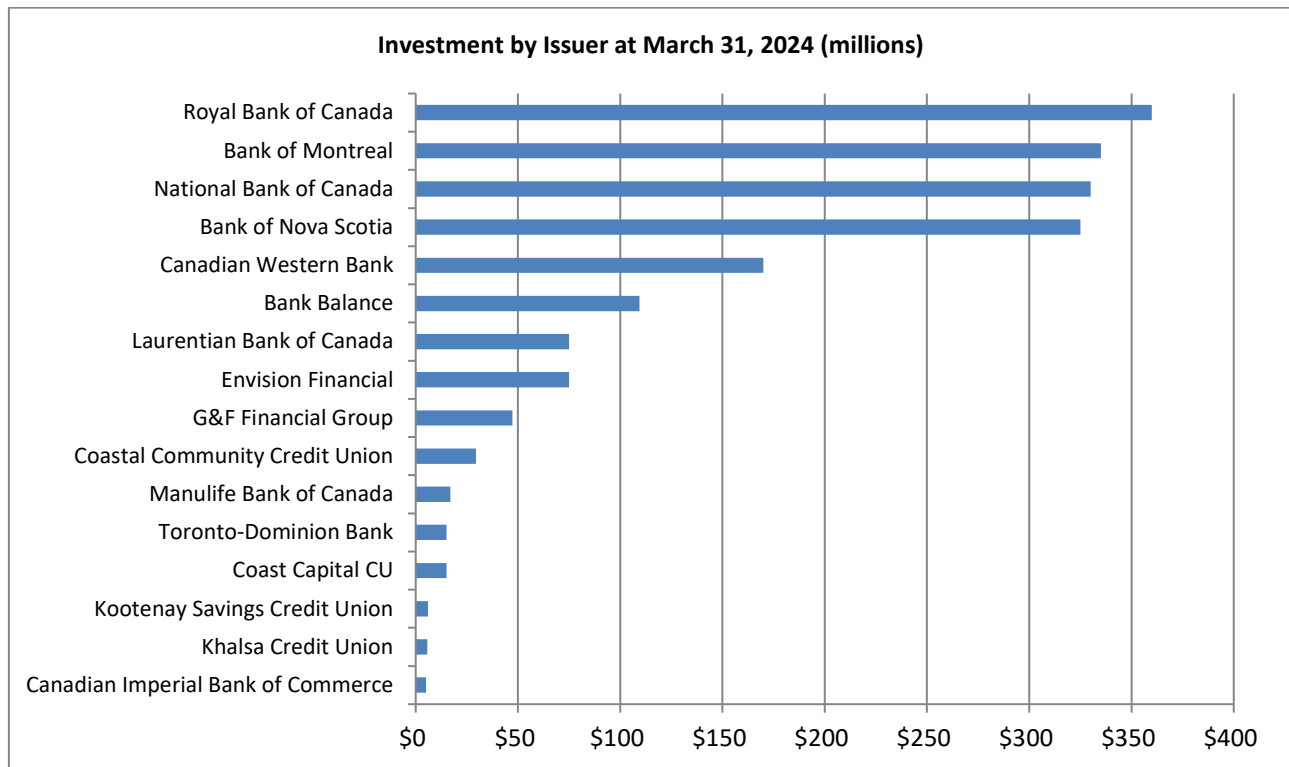


Graph 11

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

Diversification

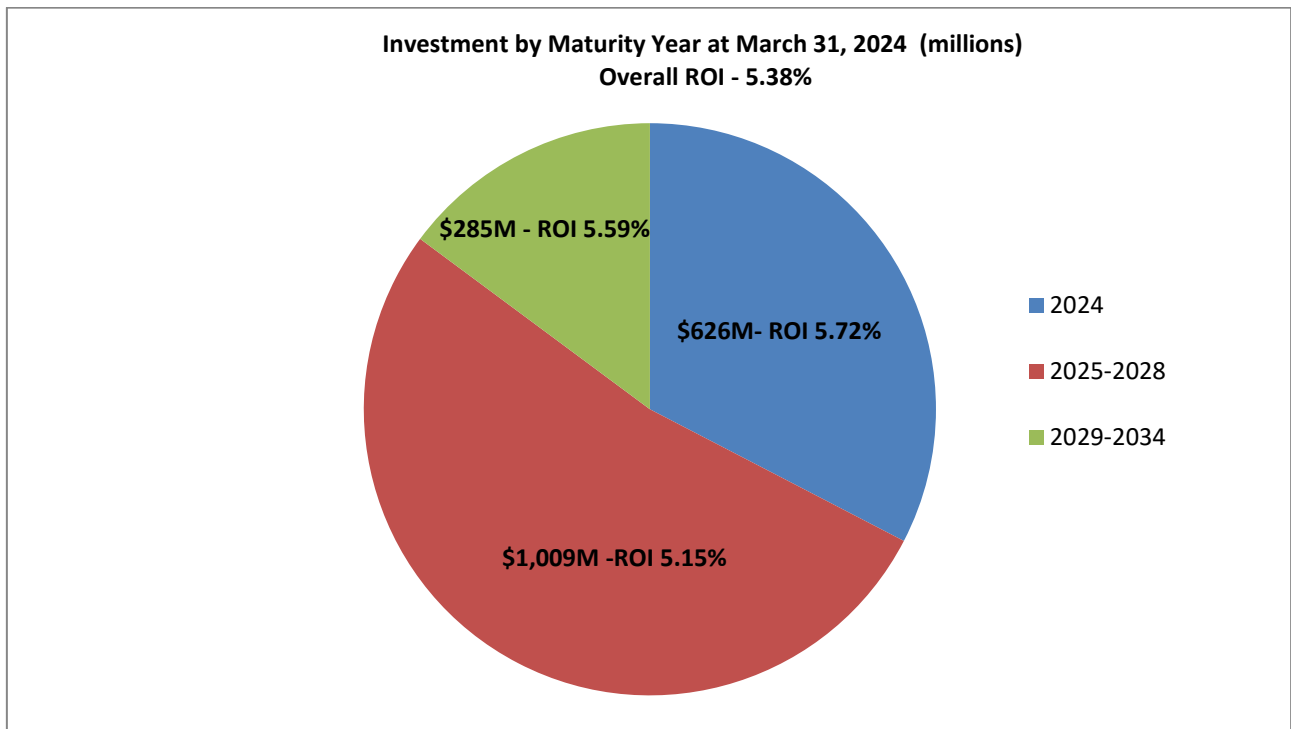
In order to reduce overall portfolio risk, the City diversifies its investment holdings across a range of security types and financial institutions. Graph 12 shows a listing of the City's portfolio by Financial Institution.



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.



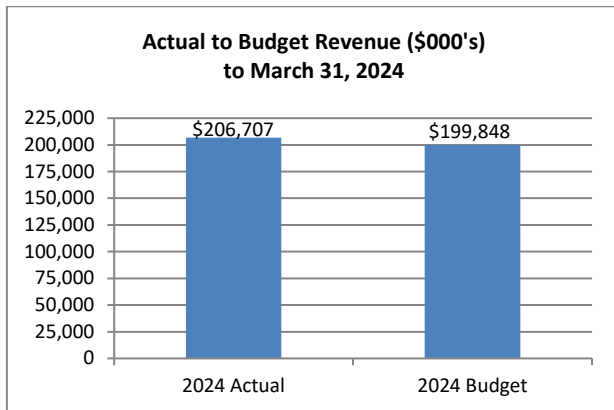
Graph 13

Return on Investment

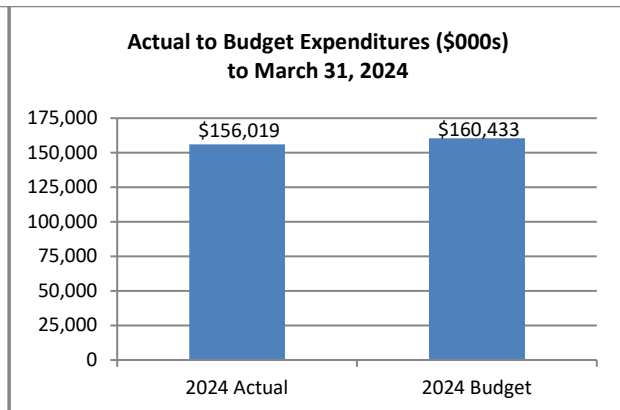
During the three-month period ending March 31, 2024, the City’s investment portfolio earned a combined return of approximately 5.38% (during the three-month period ending March 31, 2023 – 3.84%) while maintaining investment security as outlined in the City’s investment policy. The City strives to earn 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 2024.



Graph 14



Graph 15

Appendix “I” documents the General Operating Fund’s revenues and expenditures at the end of first quarter of 2024 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 2024 budget and as shown in Appendix “II”.

Police Services

The current adopted Police Services budget is based on the actual sworn member levels and operating cost requirements for both the RCMP and Surrey Police Service (“SPS”) at the end of 2023. A Police Services funding envelope of \$221.6M will provide funding to ensure adequate and effective policing in Surrey as the current combined sworn member strength, which forms the basis of this budget, exceeds the City’s authorized 2024 strength of 785 when incorporating both SPS and RCMP sworn members.

In October 2023, the City launched a petition in the Supreme Court of BC for a judicial review of the Province’s July 2023 decision to continue the police transition to the SPS. On April 23, 2024, the Province announced a transition date of November 29, 2024, for SPS to become the Police of Jurisdiction (“POJ”). The Supreme Court’s decision is still pending. Due to the uncertainty surrounding this matter, the associated financial impacts cannot be determined at this time.

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

- **Police Services** currently is on budget.
- **City Police Support Service** currently has a favourable variance of \$0.07 million, primarily due to revenues from security clearance being higher than the budget.

The Surrey Police Board Administrator periodically publishes financial updates on the Board’s website with the most recent report addressing SPS year-to-date expenditures to March 31, 2024. The financial information presented in the Administrator’s report (not including one-time Policing Transition Project expenditures) originates from SPS without input or involvement from the City’s Finance Department. SPS expenditures in the Administrator’s report may differ from the City’s financial records due to costs which are incurred and recorded outside of the City’s financial management system.

Fire Department currently has a slightly favourable variance of \$1.01 million as a result of timing of hiring of additional staff in the approved 2024 budget, and operating expenditures.

Engineering Services-General Operating currently has a favourable variance of \$1.05 million, primarily due to lower than budgeted salaries and operating costs, largely due to vacancies and timing of expenditures.

Parks, Recreation & Culture Department currently has a favourable variance of \$0.91 million. This is primarily due to vacancies and timing of expenditures.

Planning & Development Department currently has a favourable variance of \$1.4 million. This is attributable to a surge in the issuance of building permits in the first quarter, primarily due to advancement of developer project schedules in response to the expiry of the one-year rate protection period for in-stream projects for the new Metro Vancouver Water DCC.

Surrey Public Library currently has a favourable variance of \$0.24 million. This is primarily due to vacancies and timing of expenditures.

Mayor and Council currently has a favourable variance of \$0.03 million.

City Grants has a slight favourable variance of \$0.17 million, primarily due to the timing of grant disbursements resulting from Council's direction to suspend funding requests for certain grant types.

City Manager's Department has a slight favourable variance of \$0.15 million, primarily due to the timing of expenditures and savings from vacancies.

Corporate Services Department has a favourable variance of \$1.24 million, due to better-than-expected business license revenues and the timing of expenditures.

Finance Department currently has a favourable variance of \$0.66 million, primarily due to timing of expenditures and savings from vacancies.

Social Infrastructure & Community Investment currently has a favourable variance of \$0.45 million, primarily due to savings from vacancies.

CONCLUSION

Staff will continuously monitor the City's financial status relative to budget as we enter the second quarter of fiscal 2024 and will take proactive measures to address any unplanned financial challenges.

Kam Grewal
CFO / General Manager
Finance

Appendix "I": 2024 First Quarter Council Report, Executive Summary - Revenues & Expenditures
Appendix "II": 2024 First Quarter Council Report, Departmental Detail

2024 1st QUARTER COUNCIL REPORT
EXECUTIVE SUMMARY - REVENUES & EXPENDITURES
\$ 000's

	2024: 1st Qtr YTD Actual	2024 YTD BUDGET	2024: 1st Qtr YTD Variance	2024 ANNUAL BUDGET
REVENUE SUMMARY				
Net Taxation	136,596	136,596	-	543,134
Secondary Suite Infrastructure Fee	8,651	8,651	-	34,116
Other Corporate Fees	1,322	1,139	183	4,066
Investment Interest	18,754	18,371	383	70,608
Provincial Casino Revenue Sharing	818	818	-	3,273
Local Govt. Climate Action Program	3,443	3,443	-	3,443
Other Trsf from Government	3,022	-	3,022	42,683
Penalties & Interest on Taxes	1,756	1,479	277	7,000
Corporate Leases	3,086	3,086	-	13,925
Non-Tax Revenues	40,852	36,987	3,865	179,114
Program Revenues	29,259	26,265	2,994	105,228
TOTAL REVENUES	206,707	199,848	6,859	827,476
EXPENDITURE SUMMARY				
Program Expenditures, net of transfers	153,249	157,637	4,389	644,593
Council Priorities	38	38	-	260
Fiscal Services	79	70	(9)	125
Debt Interest & Principal	2,309	2,309	-	18,719
Other	345	379	34	26,442
TOTAL EXPENDITURES	156,019	160,433	4,414	690,139
CORPORATE TRANSFER SUMMARY				
Transfer to /(from) Operating Sources	(5,124)	(5,091)	34	(20,361)
Transfer to /(from) Capital Sources	123	-	(123)	-
Transfer to /(from) Reserve Sources	2,353	2,353	-	33,800
Transfer to /(from) Surplus	36,292	36,579	287	123,898
TOTAL TRANSFERS	33,644	33,841	197	137,337
Surplus (Deficit)	17,044	5,574	11,470	-
Trsf (To)From Unapprop Surplus	(17,044)	(5,574)	(11,470)	-
BALANCED BUDGET	-	-	-	-

1st Quarter YTD Actual to Budget Variance:

\$ 11,470

Appendix "II"

2024 1st QUARTER COUNCIL REPORT DEPARTMENTAL DETAIL \$ 000's

	2024: 1st Qtr YTD ACTUAL	2024 YTD BUDGET	2024: 1st Qtr YTD Variance	2024 ANNUAL BUDGET
PROGRAM REVENUES				
City Police Support Service	2,405	2,109	296	8,437
Police Services	-	-	-	-
Fire	386	296	90	5,015
Engineering Services	3,037	2,443	594	10,566
Parks, Recreation & Culture	8,899	9,221	(323)	37,249
Planning & Development	9,548	8,414	1,134	29,847
Surrey Public Library	453	371	81	1,475
Mayor & Council	-	-	-	-
City Grants	-	-	-	-
City Manager	-	-	-	-
Corporate Services	3,312	3,032	281	11,126
Finance	295	378	(83)	1,513
Social Infrastructure & Community Invest.	924	-	924	-
TOTAL PROGRAM REVENUES	29,259	26,265	2,994	105,228

	2024: 1st Qtr YTD ACTUAL	2024 YTD BUDGET	2024: 1st Qtr YTD Variance	2024 ANNUAL BUDGET
PROGRAM EXPENDITURES				
NET OF TRANSFERS				
City Police Support Service	8,594	8,368	(226)	36,817
Police Services	55,764	55,764	-	221,575
Fire	20,559	21,479	920	92,767
Engineering Services	3,209	3,667	458	14,962
Parks, Recreation & Culture	26,712	27,946	1,234	117,040
Planning & Development	6,706	6,972	266	27,580
Surrey Public Library	5,904	6,060	156	24,059
Mayor & Council	574	604	30	2,287
City Grants	231	403	172	1,611
City Manager	2,245	2,397	152	9,759
Corporate Services	17,600	18,559	959	74,788
Finance	2,612	3,352	740	12,350
Social Infrastructure & Community Invest.	2,540	2,066	(473)	8,998
TOTAL PROGRAM EXPENDITURES	153,249	157,637	4,389	644,593

	2024: 1st Qtr YTD ACTUAL	2024 YTD BUDGET	2024: 1st Qtr YTD Variance	2024 ANNUAL BUDGET
NET PROGRAM				
City Police Support Service	6,189	6,259	70	28,380
Police Services	55,764	55,764	-	221,575
Fire	20,173	21,183	1,010	87,752
Engineering Services	172	1,223	1,051	4,396
Parks, Recreation & Culture	17,813	18,724	911	79,791
Planning & Development	(2,842)	(1,442)	1,400	(2,267)
Surrey Public Library	5,451	5,689	238	22,584
Mayor & Council	574	604	30	2,287
City Grants	231	403	172	1,611
City Manager	2,245	2,397	152	9,759
Corporate Services	14,288	15,528	1,240	63,662
Finance	2,317	2,974	657	10,837
Social Infrastructure & Community Invest.	1,615	2,066	451	8,998
NET PROGRAM TOTAL	123,989	131,372	7,383	539,365