

Staff Report

Background

Similar to other Canadian cities, Richmond is not alone with its past and continued struggles with insufficient revenue sources, ageing infrastructure, provincial downloading, rapid infrastructure expansion associated with urban growth, fluctuating market conditions, decreasing reserves and a lack of control over external costs.

Over the last 10 years, City Council have had to make tough budget decisions in order to deal with rising costs, such as the provincial grant reductions in the mid-1990's. During this time, Richmond lost \$5.7 million in provincial grants, and was subject to rising external costs. Some cities chose to increase taxes and fees to deal with the loss of the grants, and rising costs. Richmond chose to absorb the loss of provincial grants and rising costs by reducing contributions to the reserves and finding significant efficiencies in order to require only nominal tax increases to property owners. Unfortunately, there are not the efficiencies available that there were 10 years ago without effecting service levels and staffing levels.

Thus, these past offsetting strategies have put the City in a tight financial situation. Although Richmond is presently in a better financial position than many other cities, this could change given rising external costs and declining reserves.

Recognizing this situation will change unless a proactive strategy is developed which will extend the economic health of Richmond over the long term and leave a positive legacy for future generations. On May 26, 2002, Council directed staff to develop a Long Term Financial Management Strategy.

On June 26, 2003, at a closed General Purposes Committee meeting, Committee reviewed four options that staff created to close the funding gaps and to achieve Council's measures of success for financial sustainability. After discussing the merits of the options, Council created a modified option that included targets that they agreed could realistically meet their measures of success and be acceptable to the community. The targets Council agreed on with the modified option referred to as **Option "B"** include:

<i>Tax increase: CPI+1 %</i>	<i>Total casino revenue: \$10 mil per year</i>
<i>Economic Development: 0.85% per year</i>	<i>Operating Efficiencies: -0.5% per year</i>
<i>New Alternative Revenue: \$1 mil per year</i>	<i>Service Level Reduction: -0.5% - 1st yr. only.</i>
<i>Fire & Police Efficiencies: -0.5%</i>	

After agreeing on the targets of the new option, Committee then directed the Long Term Financial Management Strategy team to report back with the following:

- 1) An analysis of Option "B".
- 2) Two scenarios which are modified versions of Option "B" which strive to achieve Council's measures of success.

- 3) The required policies to implement the strategy.
- 4) Options for a communication strategy.

This report addresses the above referral.

Findings of Fact

All of the options developed as part of the strategy are intended to assist the Corporation to achieve **Council's Measures of Success** which include:

- (1) A Long Term taxation plan that will enable the City to tie property tax increases to a specific relationship with **CPI** beginning this term of office.
- (2) City reserves will be increased to the 1995 level or better.
- (3) The City will have diversified revenue sources, through diversification of its land use, tax base, business base and new alternative sources of funding.
- (4) A Cost Control/Containment Plan, which will control expenditure growth, rationalize resources, and that provides a continuous review of the relevancy of existing operating and capital costs.
- (5) The strategy should enhance the City's economic well being for present and future generations without sacrificing the City's attractiveness, liveability and overall quality of life.

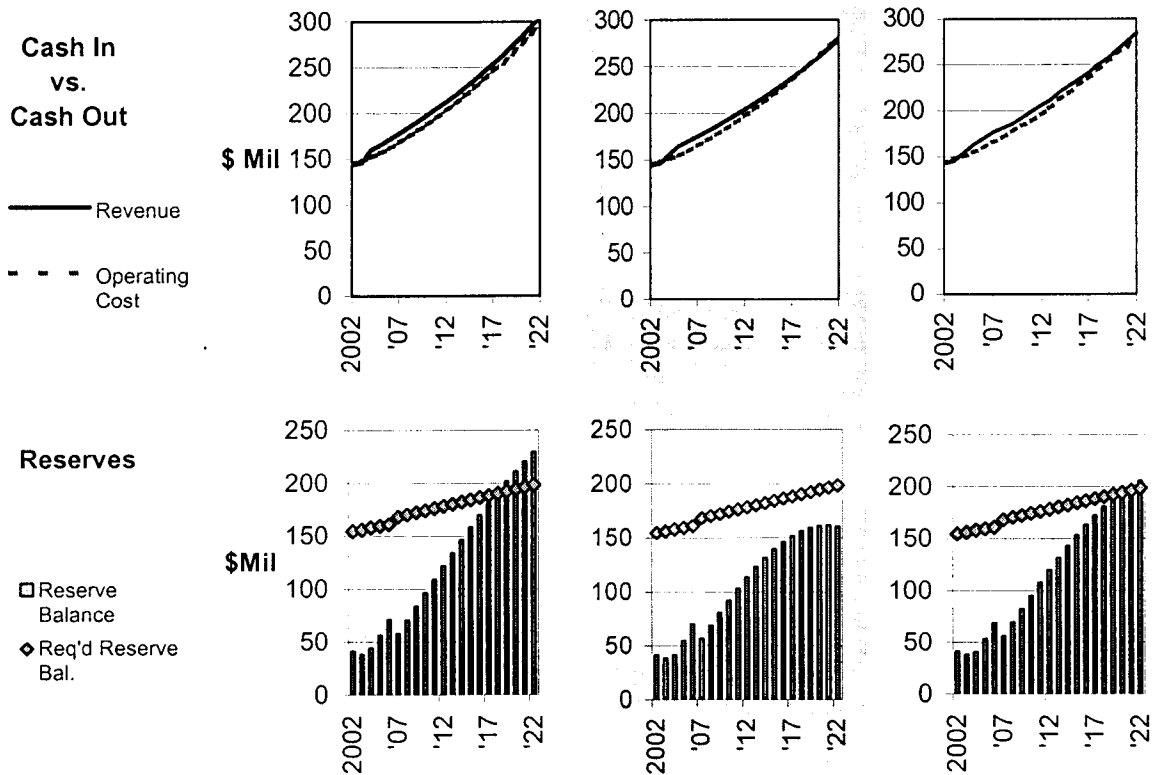
Analysis

A) Option "B" & Scenarios

Council used the financial model to create Option "B" as a potential strategy option and requested that two variations of Option "B" be generated for comparison. The two variations of Option "B" are referred to as Scenario Option "B1" and Scenario Option "B2". The details of the three options and the effect they have on closing the funding gaps are shown in Figure 1.

Figure 1. Options Summary

Variable	Option B1	Option B	Option B2
Tax Increase	CPI + 1% every year	CPI + 1% every year	CPI + 1.3% every year
Economic Development	1.5% per year	0.85% per year	0.7% per year
New Alternative Revenue	\$1 Mil per year by the 5 th year	\$1 Mil per year	\$1 Mil per year by the 4 th year
Total Casino Revenue	\$10 Mil per year by the 2 nd year	\$10 Mil per year	\$10 Mil per year by the 2 nd year
Fire and Police Efficiencies	-0.2% per year start in 3 rd year	-0.5% per year	-0.5% per year
Operating Efficiencies	-0.2% per year start in 3 rd year	-0.5% per year	-0.5% per year
Service Level Reduction	No reduction	-0.5% in the 1 st year only	-0.1% per year for the first 5 years



Option Variables

As part of the development of Scenario Option “B1” and Scenario Option “B2”, the team examined various ways that the variables could be adjusted and still realistically meet Council’s measures of success. A description of the variable combinations used in the options is discussed below.

Tax Rate

The increase in the tax rate was adjusted as little as possible with the two new options. The rate of CPI+1% identified in Option “B” was considered realistic and effective for long term implementation. Thus, Scenario Option “B1” also uses CPI + 1%. Whereas, Scenario Option “B2” uses a slightly higher rate of CPI+1.3% to largely compensate for the reduced economic development and phased growth in alternative and casino revenue.

Economic Development

The 0.85% economic development target used in Option “B” was considered conservative when compared to past performance in the City. Scenario Option “B1” uses the rate of 1.5% which is historically typical. Scenario Option “B2” uses the more conservative or pessimistic value of 0.7%.

New Alternative Revenue

All three options use a long term sustained amount of \$1 Mil per year of new alternative revenue. This represents \$1 Mil in revenue generated each year and is not compounding (i.e. not \$2 Mil in year two). In Option “B” this new revenue is realised in year one. In Scenario Option “B1” the new revenue is more realistically phased in over 5 years, and over 4 years in Scenario Option “B2”.

Total Casino Revenue

All three Options use a long term sustained amount of \$10 Mil per year of total casino revenue. This represents \$10 Mil in revenue generated each year and is not compounding (i.e. not \$20 Mil in year two). In Option “B” this new revenue is realised in year one. More realistically, in Scenario Options “B1” and “B2” the total is \$6 Mil in year one and then \$10 Mil per year.

Current annual casino revenue is approximately \$2 Mil. All new casino revenue will come from the Bridge point Casino development, which could be completed in 2004.

Cost Containment

There are two ways of increasing the City’s funding to cover the costs of providing services and programs. The first is to increase the City’s revenue inputs (e.g. taxes, utilities, alternative revenue etc.). The second is to contain the City’s costs through efficiencies, service level reductions, or new service delivery models. Without cost containment, the addition of new programs beyond current service levels will make it extremely difficult if not impossible to keep the tax increase at CPI+ 1%.

In order to have effective cost containment, a clear Council policy must be developed on staff growth limits and alternate service delivery models. The financial model at this time deals only with the efficiencies and service level reductions components of cost containment.

That is, City operating efficiencies of -0.5% per year are identified in Option “B” and Scenario Option “B2”. In Scenario Option “B1” the efficiency rate is reduced to -0.2%, taking advantage of the increase in economic development. The efficiency targets may be the most challenging targets to achieve. For example, the majority of costs for Fire and Police are personnel related and these costs, and their short term growth rates, are fixed in labour agreements and contracts. Salaries reflect 86% of Fire costs and salaries/contracts reflect 99% of Police costs. The establishment of staff growth limits would however help to contain rising costs.

The service level reductions in all three options have a minor impact on the overall financial picture. The reduction is zero in Scenario Option “B1”, taking advantage of the increase in economic development.

Capital Program Reduction

None of the three options have capital program reductions as deferred capital would generate greater costs in the long term.

B. Supporting Policies

This section of the report outlines the issues, and the resulting policies that are necessary to implement the Long Term Financial Management Strategy. In order to successfully implement the strategy and achieve Council’s measures of success, all the policies need to be adopted and implemented. The policies support Options (B, B1, and B2) contained in this report. Any major changes to the policies will affect the outcomes of the options that were generated by the financial model.

REVENUE

1. Tax Revenue

Issues

- Richmond, like other Canadian cities, relies on general property taxes as a major source of revenue. Property taxes are not indexed to inflation like income taxes are and as a result do not automatically generate as much revenue.
- In addition to collecting property taxes to cover City operations, Richmond is also required to collect taxes for the School Board, BC Assessment Authority and the Regional District. Increases to these taxes are often perceived as increases in City operating expenses.

- Without a Long Term Financial Management strategy to protect the City's present and future economic health, the annual budget process is often reactive and based on crisis management resulting in increased costs in subsequent years.
- There are increasing expectations from the ageing population for the City to provide high service levels with no tax increases.
- Only the water, and sanitary sewer systems have dedicated sources of revenue for operation, maintenance and replacement through utility rates. A utility rate is also in place to fund future dyke and drainage system infrastructure replacement but not operation or maintenance. There is also a dedicated revenue source to fund sanitation and recycling operations. Operation, maintenance and replacement of all other infrastructure are funded through general revenue, which is largely supported by property taxes.
- As a result of rising costs, there is always the temptation of reducing the contribution to the City's reserves in order to minimize the tax increase. As demonstrated in 1995, decreased contributions to the reserves in order to avoid passing on the costs of losing the provincial grants to the tax payers has had a negative compounding effect on the reserve balances.
- Historically, additional new programs and projects have been absorbed, and as a result less funding gets transferred to the reserves.

Policy One

Tax increases will be at Vancouver's CPI rate (to maintain current programs and maintain existing infrastructure at the same level of service) plus 1.0 % towards infrastructure replacement needs.

Rationale

- CPI increases are required to cover our current programs and maintain existing infrastructure at the same level of service.
- The provision of additional programs will require a tax increase beyond CPI+1.
- The use of CPI will help to strengthen the perception that the City is operating efficiently. It also demonstrates that city operations are not exempt from the effects of inflation.
- The separate identification of a dedicated percentage for infrastructure replacement clearly shows the City's commitment to protect the long term economic viability of Richmond.
- The use of CPI plus an infrastructure contribution should help to simplify the intent of the financial strategy of building the reserves and keeping City taxes as close as possible to the rate of inflation.
- A simple strategy that is well communicated will help to clarify the difference between City taxes and taxes of other authorities.

2. Gaming Revenue

Issues

- The City is eligible for 10% of net casino revenues.
- It is not sustainable over the long term to utilize gaming revenue in the operating budget as it could be reduced or eliminated at any time by senior levels of government and/or participation rates could decline resulting in less revenue.
- There is flexibility with this revenue source as it is up to individual Councils to set policies as to how these revenues are spent.

Policy Two

Gaming revenues will go directly to the capital reserves, the grants program and a community legacy project reserve.

Rationale

- Due to their variable nature, gaming revenues should be treated as “one time revenues” because the City could lose them at any time so they should go to one time expenditures such as a capital replacement, grants or a community legacy reserve. General Guidelines would need to be created and approved by Council outlining what an appropriate community legacy project could be.
- This approach will help to replenish the capital reserves and provide Council with the flexibility if desired to implement significant community programs as well as to contribute to the community grants program.

3. Alternative Revenues & Economic Development

Issues

- Some of the alternative revenues available to the City such as user fees and pay parking may not be acceptable to some members of the community particularly when they are first introduced. Further debate and clear direction is needed in order to meet the alternative revenue targets of the strategy.
- New economic development and alternative revenues should contribute to the long term vision of the city. For example, although it could generate revenue, corporate billboards at the entrance to the City would not help to achieve the “appealing” component of Richmond’s vision.
- New tax revenue generated from economic development is dependent on variable market conditions.

Policy Three

Any increases in alternative revenues and economic development beyond all the financial strategy targets can be utilized for increased levels of service or to reduce the tax rate.

Rationale

- Once all the overall revenue targets of the chosen strategy option are met, there is flexibility to use the additional revenue to reduce the tax rate. (It is important to note, that if a particular revenue variable exceeds its target that it can be used to compensate for a variable that has not met its target.)

- This policy helps to ensure that the necessary revenue targets are met, but also provides an opportunity to help reduce the tax rate if the targets are exceeded.

4. Changes to Senior Government Service Delivery

Issues

- Changes in senior government service delivery models or further reductions in grants could result in increased costs to the City.

Policy Four

Any additional costs to the City as a result of senior government policy changes should be identified and added to that particular year's taxes above and beyond the CPI and infrastructure percentage contribution.

Rationale

- This approach will avoid the problems that occurred in 1995 when the contributions to the reserves were used to cover the cost of the grant reductions.
- A communications strategy will be required to help clarify the source of any additional costs to the taxpayers.

5. Capital Plan

Issues

- There are costs associated with creating a liveable City that is attractive both to residents and businesses.
- Growth also leads to an increased demand for adding new and expanded services and facilities to serve a diverse urban population.

Policy Five

Ensure that long term capital funding for infrastructure (e.g. parks, trails, facilities, roads etc.) is in place in order to maintain community liveability and generate economic development.

Rationale

In order to maintain a strong tax base, remain competitive and stimulate economic development in the City, investment in services and capital infrastructure needs to be made to make the City an attractive place to live and work.

6. Cost Containment

Issues

- Because there are costs associated with creating a highly liveable and viable City, there needs to be a continuous review of the relevancy of the existing operating and capital costs to ensure that the services, programs and projects delivered continue to be the most effective means of achieving the desired outcomes of the City's vision.
- CPI tax increases are required to cover our current programs and maintain existing infrastructure at the same level of service. Whereas, the provision of new or expanded programs provided in addition to existing programs will result in an additional tax increase beyond CPI.

- Cost containment can be achieved through efficiencies, service level reductions and new service delivery models.
- Pre-approval of additional programs without determining if there is another program that can be replaced or provided differently will lead to cost over-runs.

Policy Six

Staff increases should be achieved administratively through existing departmental budgets, and no pre-approvals for additional programs or staff beyond existing budgets should be given.

Rationale

- This policy provides a start to cost containment. It will enable the City to better meet the strategy targets by having controls on cost growth.

7. Efficiencies and Service Level Reductions

Issues

- The continuous search for efficiencies is a sound business practice.
- In the past efficiencies and service level reductions have traditionally been used to reduce the tax rate rather than to replenish the reserves.
- In 1997, the Corporate Efficiency Program was implemented across the organization resulting in \$3.2 million reduction in expenditures. Although staff have continued to search for additional efficiencies, future savings are unlikely to be as significant as they were in 1997.
- Richmond is known for its excellent facilities, open space system and high level of services.

Policy Seven

Savings due to efficiencies or service level reductions identified in the strategy targets should be transferred to the capital reserves. Any savings due to efficiencies beyond the overall strategy targets can be utilized to reduce the tax rate or for increased levels of service.

Rationale

- Once all the required targets of the selected strategy option targets are met, an opportunity exists to reduce tax increases or improve level of services. It is unlikely that there will be additional money available from efficiencies though, because it is going to be difficult enough just to meet the targets and continue to provide high levels of service.
- This policy results in additional money going to the reserves at no additional impact to the taxpayer.
- The ability to use efficiencies beyond the strategy option targets for service level improvements will provide additional incentive at all levels in the organization to rationalize existing resources and to review the relevancy of existing operating and capital costs.

8. LAND MANAGEMENT

Issues

- Land assets have a long term community and economic value.
- Revenue can be realized through rent, and leases in the short term.
- The City has lower holding costs than most private interests.

Policy eight

Land assets should not be sold to finance the purchase of depreciating assets.

Rationale

- This policy will enable the City to utilize the land inventory as a revolving fund, and realize the long term value of an asset.

9. ADMINISTRATIVE

Issues

- Currently, the City does not have a simple report card as to how well the City is doing in terms of financial sustainability.
- The financial model used to create the strategy options, is based on past performance, and an environmental scan, which takes into account current and projected future economic conditions.
- Currently user fees are not adjusted to inflation.

Policy Nine

As part of the annual budget process the following shall be undertaken:

- *all user fees will be automatically increased by CPI;*
- *the financial model will be used and updated with current information, and*
- *the budget will be presented in a manner that will high light the financial strategy targets and indicate how the budget meets or exceed them.*

Rationale

- This policy will ensure that the financial model continues to provide Council with the best information possible to guide the strategy and to demonstrate the City's progress towards achieving long term financial sustainability.

10. DEBT MANAGEMENT

Issues

- There are costs associated with borrowing money to finance infrastructure replacement.

Policy

Utilize a "pay as you go" approach rather than borrowing for financing infrastructure replacement.

Rationale

- This policy will enable the City to contain the payment amounts and continue paying off existing debt. When the debt is retired the same payments could then be transferred to the reserves for infrastructure replacement and to further reduce our reliance on borrowed money.

C. Implications of the Strategy

The implications associated with implementing the strategy are as follows:

- The funding gaps are closed and Council's measures of success are achieved over the long term.
- A cost containment plan needs to be developed and adhered to.
- The need for new economic development will continue to play an important role in the the City's financial situation.
- Some difficult philosophical decisions will need to be made by Council on what are acceptable alternative revenues (e.g. user fees, pay parking, etc.) and alternate service delivery methods.
- Due to the absorption of senior level downloading, and rising external costs combined with nominal tax increases in the early in mid to late-1990's, the City is in a financial position, that there is no room for further operating cost reductions without a corresponding reduction in services or programs. Since 67.9 % of the budget is directly related to salary costs, any reductions to levels of service, programs, customer service will result in reduction of staff. For example, a \$1.5 million dollar cut to the operating budget will result in the termination of 16 to 23 staff on average.
- Significant service level cuts will affect the long term liveability and viability of Richmond, therefore, reducing the attractiveness of future economic development in Richmond.
- No new programs or increases in levels of service will be possible without exceeding the desired tax increase rate of CPI plus 1% unless the economic growth, alternative revenue or efficiency targets are surpassed.
- All the policies contained in this report must be adopted and adhered to as they complement and support each other.

D. Strategy Implementation

Given the implications, staff identify three approaches for implementing the Long Term Financial Management Strategy.

- (1) The ***first approach*** calls for implementing Scenario Option "B1" plus additional service level or program cuts as part of the 2004 budget. That is, in order to achieve the CPI + 1% tax increase included in Scenario Option "B1", \$1.5 million would need to be generated from additional service level or program cuts.

The pros of this first approach are:

- It displays a clear signal that Council is taking steps towards achieving long term financial sustainability.
- It is the start of a proactive rather than reactive approach to the budget process.

The cons of this first approach are:

- There will be a significant impact on levels of service or programs resulting in the reduction of 16 to 23 staff members.
- The reductions in levels of service or programs will have a long term negative effect on the attractiveness of the City as a place to live and attract businesses. This in turn will effect the amount of future economic growth, which will impact future budgets significantly.
- There will be no time to implement a transition plan to help the community adapt to the changes in service.

(2) The ***second approach*** calls for implementing Scenario Option “B1” within the 2004 budget. This approach results in a tax increase of CPI plus 1% with the shortfall between what is required for the current level of service and programs to be offset by a corresponding reduction of the current contribution to reserves.

The pros of this second approach are:

- It will provide the City with a start towards implementing the philosophy of a long term financial management strategy.

The cons of this second approach are:

- This is the same offsetting strategy that the City used 10 years ago to deal with the provincial grant reductions
- It is contrary to Council’s goal of starting to replenish reserves.
- There is quite a bit of risk associated with this option because the financial model used to develop the targets for the strategy is based on projections. If the City does not meet all the targets and decreases the contributions to the reserves as well, Richmond’s long term financial situation will be further compromised.

(3) The ***third approach*** calls for proceeding with the 2004 budget in accordance with the 5 year plan and then implementing Scenario Option “B1” with the 2005 budget. With this approach, the financial model’s predictions for economic growth, efficiencies, would be tested. Casino revenues would be confirmed. A plan could be developed for cost containment, and policy decisions would be made on alternative revenue sources.

The pros of this third approach are:

- It is in alignment with the adopted 5 Year Plan which has been communicated to Richmond citizens.
- It provides a strategic start to long term financial sustainability.
- It provides the required time to develop a cost containment plan, review alternative revenues sources, and confirm gaming revenues.

- Any savings from the cost containment plan or increased revenues from gaming or economic development would be directed to the reserves as per Policy 7 contained in this report.
- It provides the time and opportunity to address service level or program reductions and utilize attrition to minimize the impact on staff.
- A smoother transition for service level cuts is provided to the community.
- The projections included in the Long Term Financial model can be tested.

The cons of this third approach are:

- There may be the perception that there is no immediate progress being made on the Long Term Financial Management Strategy of the City.

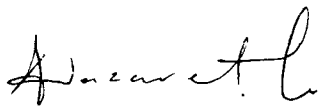
Given the pros and cons, staff recommends that Council proceed with the “Third Approach” for implementing the Long Term Financial Management Strategy.

E. Communications Plan

A key component of the Long Term Financial Management Strategy is a communications plan. As directed by Council, for discussion purposes, the team has developed a possible framework for a communications plan. (see Attachment 2). Once the Long Term Financial Management Strategy is endorsed and the accompanying policies are adopted, staff will develop a comprehensive communication plan, which would be rolled out in stages.

Conclusion

This report contains policies and three strategy options for implementing the Long Term Financial Management Strategy. Staff are recommending that Council adopt the policies and endorse the “Third Approach” contained in this report for implementing the strategy.



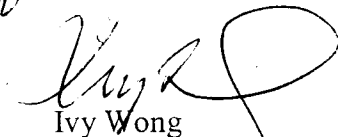
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Attachment 1: Long Term Financial Management Policies

- 1) Tax increases will be at Vancouver's CPI rate (to maintain current programs and maintain existing infrastructure at the same level of service) plus 1.0 % towards infrastructure replacement needs.
- 2) Gaming revenues will go directly to the capital reserves, the grants program and a community legacy project reserve.
- 3) Any increases in alternative revenues and economic development beyond all the financial strategy targets can be utilized for increased levels of service or to reduce the tax rate.
- 4) Any additional costs to the City, as a result of senior government policy changes, should be identified and added to that particular year's taxes above and beyond the CPI and infrastructure percentage contribution.
- 5) Ensure that long term capital funding for infrastructure (e.g. parks, trails, facilities, roads etc.) is in place in order to maintain community liveability and generate economic development.
- 6) Staff increases should be achieved administratively through existing departmental budgets, and no pre-approvals for additional programs or staff beyond existing budgets should be given.
- 7) Savings due to efficiencies or service level reductions identified in the strategy targets should be transferred to the capital reserves. Any savings due to efficiencies beyond the overall strategy targets can be utilized to reduce the tax rate or for increased levels of service.
- 8) Land assets should not be sold to finance the purchase of depreciating assets.
- 9) As part of the annual budget process the following shall be undertaken:
 - all user fees will be automatically increased by CPI;
 - the financial model will be used and updated with current information, and
 - the budget will be presented in a manner that will highlight the financial strategy targets and indicate how the budget meets or exceed them.
- 10) This policy will enable the City to contain the payment amounts and continue paying off existing debt. When the debt is retired, the same payments could then be transferred to the reserves for infrastructure replacement and to further reduce our reliance on borrowed money.

Attachment 2: Communication Plan

Initial Media Release, Advertising and Publicity Campaign

This portion of the plan could include full-page ads in the Richmond Review and Richmond News and additional advertising in Ming Pao, Sing Tao and the World Journal.

Media personnel could be invited to a briefing of the strategy. As part of the briefing, they could also be invited to participate in “Tax 101” course and a demonstration of the financial model. An interactive presentation of the financial model could also be adapted for the City website.

Communication of the Long Term Financial Management Strategy (LTFMS) through the Initial Budget Cycle

A public survey could be conducted to identify primary financial issues and public understanding of those issues. A four-page brochure could also be developed and delivered to all homes in Richmond explaining the LTFMS and displays in civic open houses or other public events could be held with financial model demonstrations.

To measure performance, a financial report card could be developed for delivery at annual budget meetings.

Tax Cycle

The City Page and website could be used to reinforce the impacts of the LTFMS on resident’s tax bills. The annual tax notice insert could include LTFMS information and a breakdown of the complete bill, rather than just municipal portion.

Communication Strategy Continued Annually

Portions of the communication plan, including the report card and tax notice items, could be repeated and re-developed on an annual cycle. This would both reinforce the general message and allow for strategic adjustments and changes to be communicated in the context of the overall plan.