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REPORT
Meeting Date: 2021-04-22
Regional Council

For Information

REPORT TITLE: **2021 Update of the Region of Peel's Financial Condition**

FROM: Julie Pittini, Acting Commissioner of Finance and Chief Financial Officer

OBJECTIVE

To provide an annual update on the Region of Peel's financial condition and management actions under its Long Term Financial Planning Strategy.

REPORT HIGHLIGHTS

- The Region of Peel's ("Region") Triple "A" AAA/Aaa credit rating has been reaffirmed by Standard & Poor's Global Ratings and Moody's Investors Service, making Peel one of twelve Canadian municipalities to hold that rating.
- Actions implemented from the 2020 Financial Scorecard include updating the Debt Management Policy and Capital Financing Strategy to Council.
- The Financial Scorecard shows the Region is within acceptable ranges for eight of the ten financial indicators. Recommended actions for ten indicators are included in Appendix 1.
- The 2021 Financial Scorecard includes actions to mitigate longer term risks to ensure the Region continues to remain financially healthy.
- The Region's overall financially healthy state will be leveraged to support the impact of the COVID-19 pandemic on critical services to the community as well as the financial impact to its residents and business community.

DISCUSSION

1. Background

In 2013, Regional Council approved the first Long Term Financial Planning Strategy (the "Strategy") to address the increasing financial pressure from Peel's growing population and evolving economy on its services and programs. The Strategy provides a long term perspective to guide decision making in support of the Region's overall financial condition and demonstrates the required balance between financial sustainability, financial vulnerability and financial flexibility.

After five years (2013 to 2017) of having the Strategy in place, an independent assessment was conducted by Ernst & Young to ensure the Strategy remains relevant and reflects the Region's priorities. A report titled "Update of the Long Term Financial Planning Strategy" was presented to Council in April 2019, which included findings of the health assessment as highlighted below:

- There has been an overall improvement in financial health as measured by the existing Strategy, demonstrating a fiscally healthy Region that has been able to achieve the stated objectives of its financial strategy.
- Through actions taken as a result of monitoring the Financial Scorecard and applying the Strategy, the Region has been able to maintain its strong credit rating.
- Compared to peer jurisdictions around Canada, Peel's Strategy is more mature and comprehensive. Therefore, updates as part of the Strategy refresh are related to re-aligning with the Region's 2015-2035 Strategic Plan, integrating the strategy with the Integrated Planning Framework, and incorporating forward-looking quantifiable indicators.

Each year an update is provided to Council on the Region's overall financial health under the principles of the Long Term Financial Planning Strategy and on its Financial Condition Scorecard including recommendations from the prior year.

a) Status of the 2020 Financial Scorecard Recommendations

The 2020 Financial Scorecard was reported to Council on April 23, 2020. To summarize, it indicated that the Region maintained its overall strong fiscal health. It also included the following two recommendations, highlighted for action through two key indicators of the 2020 Financial Condition Scorecard, to further strengthen Peel's financial condition:

- Include a 1.0 per cent tax supported infrastructure levy and a 5.0 per cent utility rate infrastructure levy in the 2021 Budget to mitigate sustainability risks in the long term; and,
- Assess the impact of Provincial funding announcements and support Council's advocacy efforts.

Infrastructure Levy
During the 2021 Budget process, the recommended 5.0 per cent infrastructure levy for utility rate supported programs was approved. As a result of removing a material capital project that was no longer required from the ten year capital plan, the 1.0 per cent tax supported infrastructure levy was reduced to 0.6 per cent with no significant additional risk. These infrastructure levies were approved as part of the overall 2021 Budget on February 11, 2021.

Impact of Provincial Funding
As highlighted through the 2021 Budget process, the Province has continued with its planned download of cost shared programs and funding freezes to the Region. A total cost share shift of $5.0 million was implemented on the Early Years & Child Care service and a funding freeze was implemented for Public Health.

Council addressed some of the funding pressures through the 2021 Budget but left $3.8 million of cost share download for Child Care to be addressed either through advocacy or through the 2022 Budget. In the interim, staff will continue to monitor, assess and leverage federal and provincial funding opportunities that support community and organizational outcomes, including infrastructure investments that support economic recovery.

Table 1 below includes an update of other actions listed in the 2020 Financial Scorecard that were recommended to help maintain Peel's financial condition.

Table 1: 2020 Actions to Address Risks

Theme	Action to Mitigate Risk	Status of Action
Dealing with Service Level Pressures	Develop a Capital Financing Strategy to better use funding resources such as capital reserves, debt, development charges and external funding	Capital Financing Strategy was endorsed by Council at the September 24, 2020 Regional Council Meeting
	Update the Debt Policy to ensure flexibility for capital priorities	Debt Management Policy was adopted at the September 17, 2020 Audit and Risk Committee meeting.
Decline in non-residential tax revenue	Support Council advocacy for diversified revenue tools	In the medium term, the Region will continue to advocate for a review of provincial-municipal funding responsibilities, a deeper understanding of the needs of municipalities and financial sustainability. In the long term, the Region will continue to work with the municipal sector to raise awareness to higher levels of government on the need for diversified revenue tools that recognize the changing nature of employment, the digital economy and their effect on land-based revenue sources (which may be more pronounced in the post-COVID-19 economy)

b) Long Term Financial Planning Strategy Supporting Council Outcomes

The Strategy is used to set priorities for the resources needed to achieve the objectives set by the Strategic Plan and supports the cost-efficient delivery of Regional services. Long term sustainability is achieved when the pillars of financial sustainability, financial vulnerability and financial flexibility are balanced.

Currently, the Strategy is being used to inform decision making and to support long term service outcomes and will continue to help provide Council with financial context as it identifies potential risks, considers new priorities, program strategies and policy changes as noted above. In 2020, these decisions included:

- Council's approval to use the tax supported year-end surpluses from 2017, 2018 and 2019 to replace the remaining debt financing portion of the Senior's Health and Wellness Village increased Peel's financial flexibility as it reduced future operating costs by $0.7 million per year.
- Implementation of the Financial Risk Management Strategy of the Regional Capital Program to assess and mitigate the impact of potential lower development charge revenue due to the pandemic.

2. 2021 Financial Scorecard

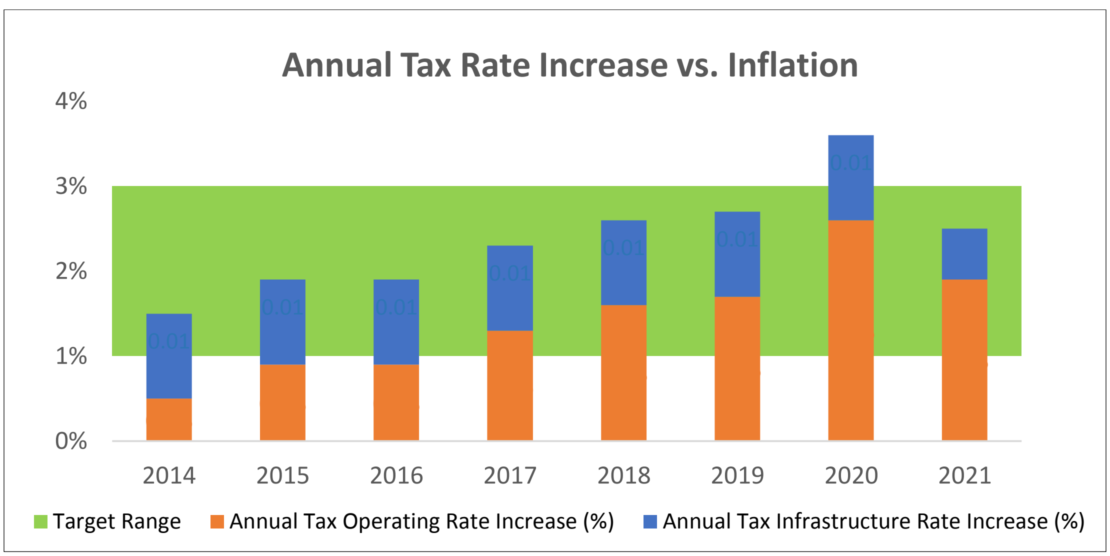
Staff assessed the Region's current financial condition using the financial performance indicators on the Financial Scorecard (Appendix I). The scorecard shows that the Region is within acceptable ranges for eight of the ten indicators and actions are recommended for all the indicators. The summary of the financial performance indicators and the recommended actions to mitigate potential risk to the Region of Peel's long term financial sustainability and credit rating are as follows:

a) Financial Sustainability:

i) Net Tax Levy Increase

Since the implementation of the Strategy in 2013, the net tax levy increase has averaged 2.4 per cent between the years 2014 to 2021, which is in line with the Bank of Canada inflation target range of 1 to 3 per cent. In the 2021 Budget, a net levy increase of 4.2 per cent was forecasted for 2022, which includes estimated provincial funding impacts and reflects the anticipated decrease in payments in lieu of taxes (PILTs) from the Greater Toronto Airport Authority due to lower passenger volume experienced in 2020.

Consistent with the principle of "Respect for the Taxpayer" within the Long Term Financial Planning Strategy, net tax levy increases that are in line with overall blended inflation; the Canadian Price Index (CPI) for operating costs and the Average Non-Residential Construction Index to recognize Peel's infrastructure intensive services are recommended. Staff will bring forward a report to Council to provide an updated estimate of the net tax levy increase for 2022 highlighting significant service pressures.

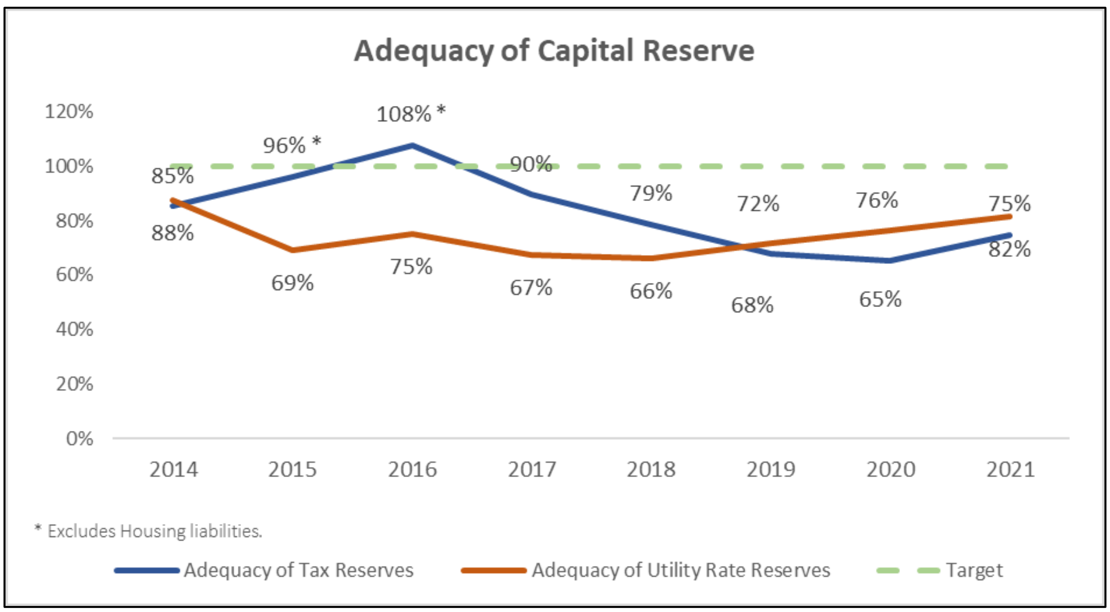


ii) Capital Reserves as a Percentage of 20-Year Capital Plan

Over the past five years, Council has approved increases to the annual contributions to both the Tax Supported and Utility Rate Supported capital reserves. While the gap between the reserves and the forecasted infrastructure requirements is decreasing, the overall 20-year capital plan continues to experience a funding shortfall.

Based on the most recent reserve adequacy assessment, current Tax Supported reserve levels and contributions have a $1.3 billion shortfall compared to the forecasted 20-year (2021-2040) capital requirements excluding the social housing stock. To address the long term Tax Supported capital requirements, a 0.6 per cent infrastructure levy was included and approved in the 2021 Tax Supported budget, which represents an increase to the annual capital reserve contribution of approximately $6.8 million. An annual increase to the reserve contributions equivalent to one per cent of the total net tax levy from 2022 to 2026 is estimated to close the funding gap assuming the capital plan doesn't increase.

Based on the most recent assessments of the Region's water and wastewater infrastructure, approximately $5.9 billion will be required over the next 20 years to predominately finance the state of good repair of water and wastewater assets. This level of investment will maintain current service levels to the public and manage infrastructure risks. To mitigate the current unfunded shortfall of $1.1 billion, an increase to the utility rate of 5.0 per cent for infrastructure or $20 million was included and approved in the 2021 Utility Rate Supported budget. Analysis shows an annual increase of 5.0 per cent for two more years until 2023 will close the current funding gap.



iii) Asset Health Score

The current overall status of the Region's infrastructure is "Good" due to Council's on-going proactive funding of infrastructure requirements and the continued support of Peel's industry leading strategic asset management approach. However, the reinvestments necessary to maintain the service levels that the public expects continue to increase. This is largely driven by aging infrastructure, additions of infrastructure to address growth, climate change and Council priorities, as well as renewed data and information on the existing infrastructure. To ensure that the Region's infrastructure is maintained, assessed and supported, it is recommended that the Region continues to mature its current asset management program and that Council continue to proactively fund the growing infrastructure needs.

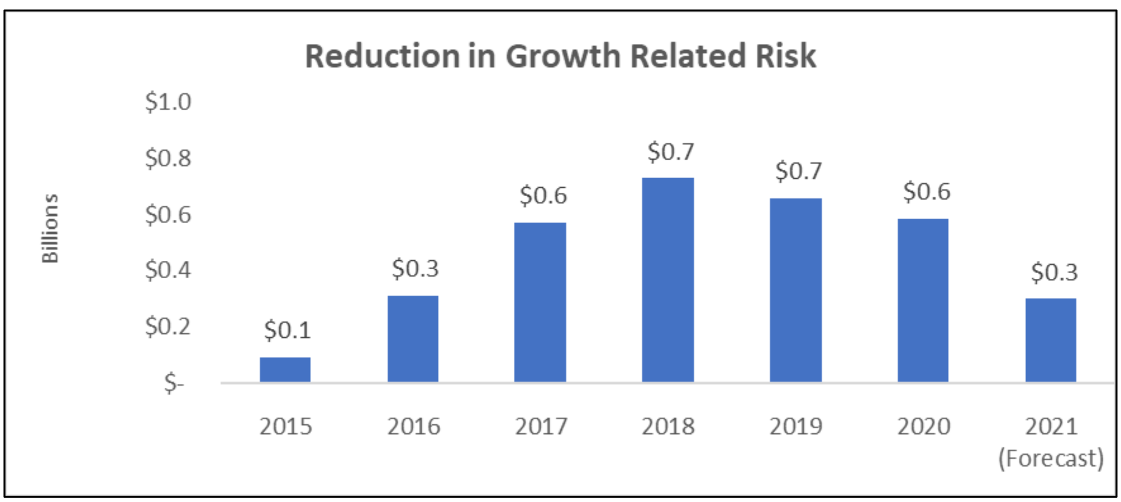
b) Financial Vulnerability:

i) Reduction in Financial Risk Associated with Growth

The outcome of the Region's Growth Management Program is focused on achieving a financially sustainable and complete community. This outcome will be achieved through delivery of four strategies, of which the strategy of managing revenues and expenditures has led to deferred debt and expenditure reductions totaling $585 million compared to the 2015 Development Charge Background Study.

The Region's 2020 Development Charge By-law update was put into effect on January 22, 2021. Due to changes in Peel's employment landscape, non-residential building permit activity and new developments in the approvals process indicate non-residential gross floor area will not meet the floor space set out in the forecast. The non-residential shortfall is attributed primarily to the lack of new office space being constructed and declining demand on commercial spaces. These existing challenges are amplified by COVID-19 which could result in limited future financial flexibility and sustainability for the Region. Changes to the Development Charge Act through Bill 108 will have major implications for Development Charge revenue and cash flow flexibility.

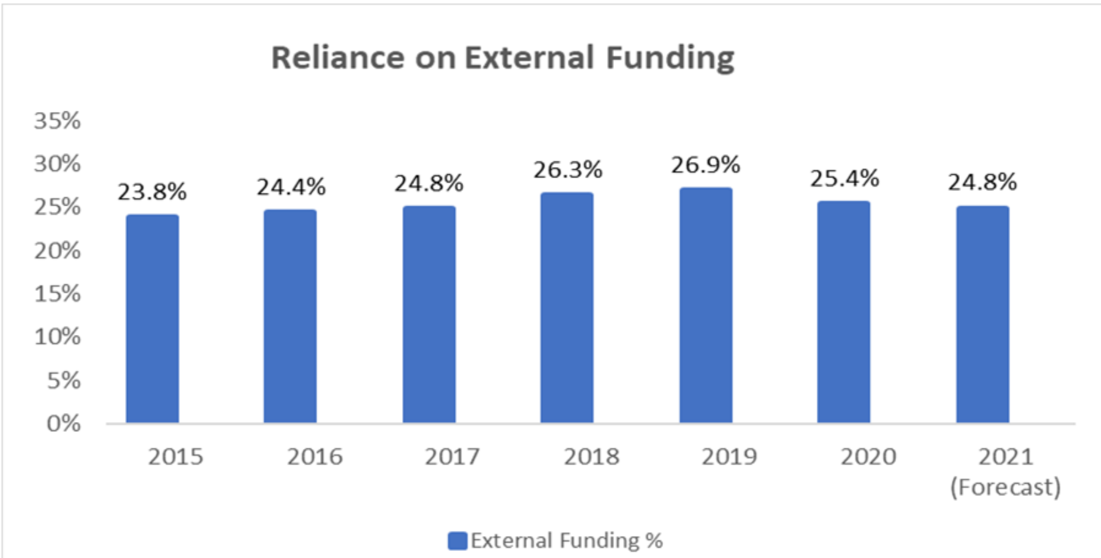
The integrated Growth Management Strategy has provided greater flexibility in managing expenditures and enhancing revenue which has reduced the financial risk associated with growth. In addition, staff will be providing a report to Council to pilot a Tax Increment Equivalent Grant program in partnership with the local municipalities to incentivize office building space. Efforts will continue to track development activities within the Region which will help inform prioritization and strategic phasing of future infrastructure spending while accommodating growth. The Region will implement its new Development Charge Interest Rate Policy to mitigate potential financial risks resulting from Bill 108.



ii) Reliance on External Funding

Provincial funding is a key source of revenue to offset municipal costs in delivering Health and Human Services as it represents one quarter of the Region's overall operating revenue.

The Region is mandated to deliver many Provincial programs such as Child Care, Housing Support, Ontario Works, Paramedic Services and Public Health. Funding related to these and other programs have increased over the past seven years from $483.8 million in 2015 to $667 million in 2021, an increase of 37.8 per cent. This increased funding has supported Peel in its provincially legislated obligations.



In 2019, the Province of Ontario began implementing its plan to reduce funding to several services by downloading more costs to the Region. In the 2021 Budget, there was reduced provincial funding for Child Care for $5 million, Community Investment for $1.8 million and funding was frozen for Public Health services (Infectious Disease Prevention, Chronic Disease Prevention and Early Growth and Development).

To minimize vulnerability, an investment of $3.0 million in property tax dollars was approved by Regional Council to maintain core service levels in impacted services for 2021 deferring $3.8 million in funding pressure to 2022. Advocacy is required to ensure that costs for provincially mandated programs don't continue to be downloaded to Peel.

iii) Proportion of Non-Residential Tax Revenue

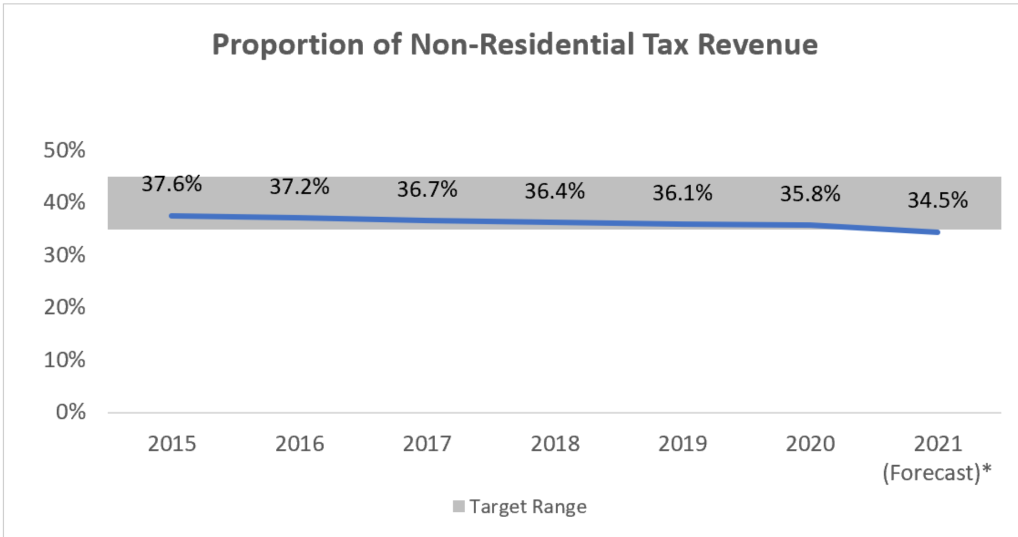
Over the past five years, the proportion of tax revenue from the non-residential sector has steadily declined from 37.2 per cent in 2016 to 35.8 per cent in 2020 primarily due to the changing nature of employment. The tax burden continues to shift from the non-residential sector to the residential sector resulting in a greater share of the tax burden falling on Peel residents. Any impacts due to COVID-19 will not be known until future years. However, numerous recent articles have indicated that the impacts of COVID-19 on businesses, especially small businesses and commercial sector, could result in many permanent non-residential closures which would put further pressure onto the residential taxpayers as the tax burden shifts onto them.

In 2019, the Region of Peel commissioned the Mowat Centre to complete a research paper "Rethinking Municipal Finance for the New Economy". The paper reviewed the implications of the changing nature of employment on municipal fiscal sustainability and resulting shift in the property tax burden to residents. The findings were presented at the August 2019 AMO conference, and also featured in a number of publications including a Public Sector Digest article, Building a Field of Dreams: The Risk of Municipal Financial Sustainability in Ontario; the Federation of Canadian Municipalities (FCM) report, The Case for Growing the Gas Tax Fund, and the Government Finance Officers Association (GFOA) report, Property Tax Disrupted. This issue was also included in the Region's 2020 Provincial pre-budget submission.

On February 13, 2020 Regional Council adopted Resolution 2020-87. The resolution authorized staff to request from the Ministry of Finance regulatory authority to pass a by-law pursuant to subsection 313(1.3) of the *Municipal Act, 2001,* as amended, (the "Ministerial Regulatory Authorization") to diminish the vacant and excess land subclass reduction for the commercial and industrial tax classes to 15 per cent in 2020 (the "Diminished Subclass Reduction") and to eliminate the reduction thereafter. The Reduction will no longer apply in 2021 and future taxation years. It is anticipated that this tax policy may help mitigate certain risks associated with the tax burden shift.

The 2020 Ontario Budget, released on November 5, 2020, introduced an optional small business subclass effective for the 2021 and future taxation years, which will provide a reduced tax rate for eligible small businesses. Implementation of this subclass is currently being reviewed by Regional and Local Municipal tax policy staff. It is important to note that any reductions in property taxes for one property class will shift the property tax burden to the residential and other property classes.

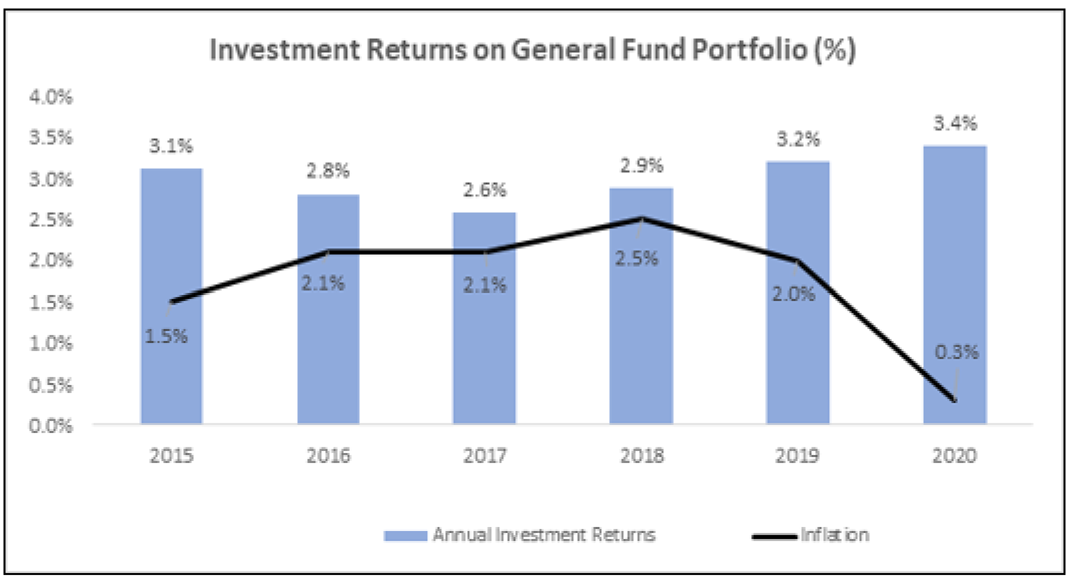
Municipalities will be notified of the requirements to implement the subclass once the regulation has passed. Additionally, the 2020 Ontario Budget also included measures to reduce the Business Education Taxes (BET) in 2021 to 0.88 per cent for non-residential properties. As a result, the BET share of the overall taxes would decline as well. Through its advocacy efforts, the Region continues to look for opportunities to educate stakeholders and provincial and federal officials on the issue of municipal fiscal sustainability.



**2021 is preliminary*

iv) Investment Returns

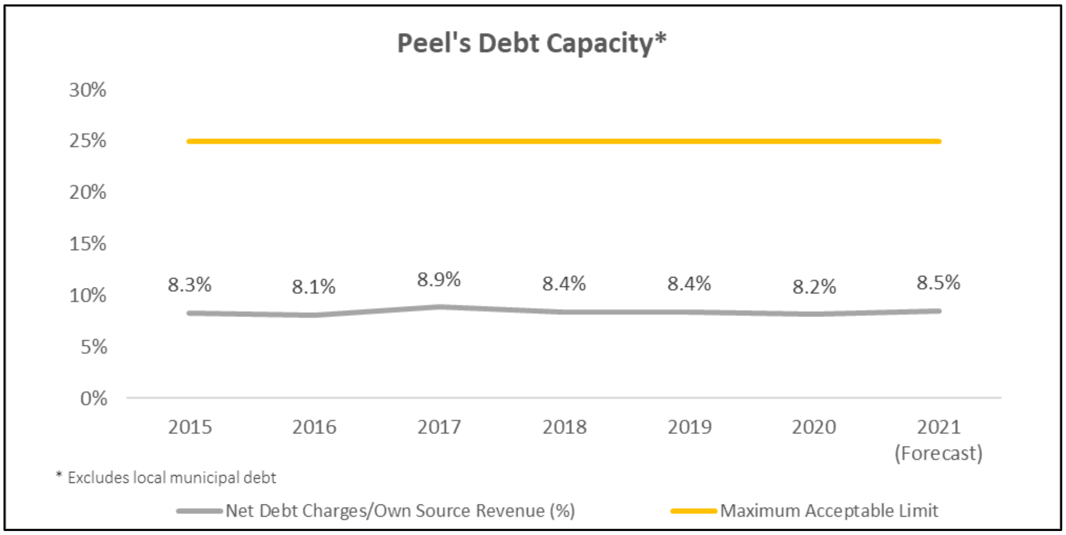
During 2020, investments generated a return of 3.4 per cent, with a four-year average return of 3.0 per cent. Portfolio returns have been above inflation, which has averaged 1.7 per cent over the past four years, helping to preserve the purchasing power of the Region's funds and meeting future funding requirements. In 2020, the Region allocated 5.0 per cent of the portfolio to equities to diversify portfolio holdings.



c) Financial Flexibility:

i) Debt Capacity

The Annual Repayment Limit has been stable, below maximum acceptable limit. The year over year decline results from a combination of changes in own source revenues, principal repayments, and new additional debt service. The forecasted increase in 2021 is based on increased provision payments from debt issued in 2020 along with expected interest expense increases related to debt issuance in 2021.

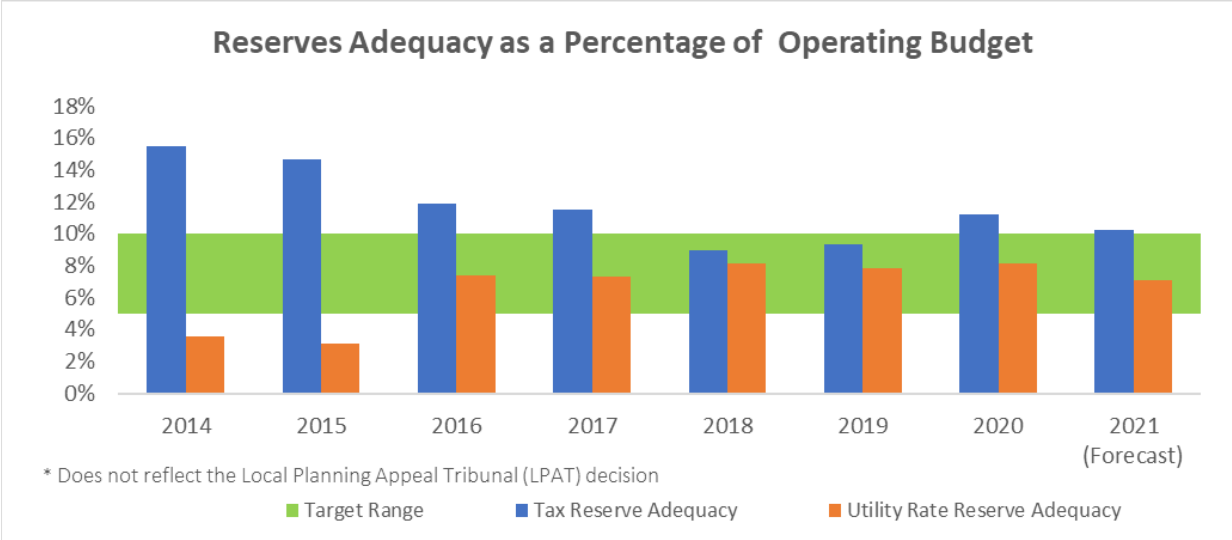


ii) Reserve Adequacy

The balance of the Tax Supported Rate Stabilization Reserves as at December 31, 2020 was $168 million reflecting the 2020 year-end recommended surplus allocations, or 11.2 per cent of the 2020 Tax Supported Operating Budget, which marginally exceeds the prescribed upper limit of the 5 per cent – 10 per cent range. This higher balance can be leveraged to support the impact of the COVID-19 pandemic on critical services to the community as well as the financial impact to its residents and business community.

The balance of the Utility Rate Supported Stabilization Reserves as at December 31, 2020 was $45.7 million or 8.2 per cent of the 2020 Utility Rate Supported Operating Budget, which is in compliance with the prescribed requirement.

Over the past five years, the Region has made progress in ensuring its tax and utility rate reserves fall within the target range of the Region's operating budget.



iii) Liquidity

The Region continues to maintain exceptional liquidity. As the capital cash flow forecasting improves, liquidity levels may be strategically reduced optimizing the long term returns to the Region's investment portfolio.

3. Impact of the COVID-10 Pandemic

a) Impact on 2020

The pandemic has had a significant impact on the broader economy and the finances of all municipalities. Requirements for self-isolation and physical distancing, as well as temporary closures of non-essential services have contributed to the downturn of the economy.

At a Regional level, the Region of Peel provided support to those financially challenged to pay property taxes and water/wastewater bills by waiving interest and penalties and by deferring the 2020 utility rate increase. These strategies resulted in a deferral of $4.6 million in utility revenue in 2020 but with the increased water consumption from the residential sector, the overall utility revenue slightly exceeded what was included in the 2020 Budget. And, with respect to property taxes, they flowed from the local municipalities earlier than expected and in combination with a lower interest rate, there was no impact to tax revenue in 2020.

At a service and program level, COVID-19 related costs and pressures have primarily affected Paramedic Services, Long Term Care, Public Health, Homeless shelters, and Housing, with these pressures alleviated in part by program specific funding from the Federal and Provincial governments.

In addition, the Region was allocated $47.8 million through the Safe Restart Program to address COVID-19 related costs and pressures not covered through program specific funding. $16.9 million was utilized during the 2020 operating year and the remaining $30.9

million was placed in a separate reserve (Safe Restart Program) to address temporary COVID-19 related costs and pressures in the 2021 Budget year. Staff will provide additional details on the impact of COVID-19 on the 2020 fiscal year through the 2020 Third Triannual Financial Performance report in May 2021.

b) Impact on 2021

Looking forward, Health and Human Services such as Public Health, Long Term Care, Housing and Child Care will continue to experience COVID-19 related costs and pressures. The impact on the Region of Peel's 2021 year-end financial results will depend, to a large extent, on the cost of Peel's Mass Vaccination Program, the duration of the pandemic and the level of funding that will be provided by the Province to address these costs.

At a Regional level, investment revenue is expected to remain mostly stable in 2021 or decrease marginally as a result of interest rates trending lower over the past several years. Short-term holdings have been reduced from the increased levels in 2020, that were in place to protect against rising volatility and potentially higher liquidity requirements through the course of the COVID-19 pandemic. While uncertainty surrounding the COVID-19 pandemic still exists, the General Fund Portfolio has been positioned and is continuously monitored to balance liquidity requirements over the short-term with the objective of earning a competitive rate of return on Regional funds over the long run.

Overall, the Region's financial health will continue to be leveraged to mitigate the impact of the COVID-19 pandemic on the sustainability of the Region's critical services for its community, and its economy.

CONCLUSION

The Long Term Financial Planning Strategy has helped Peel remain financially healthy since its adoption in 2013 and will continue to help guide Peel through challenging economic times. The updated Strategy and 2021 Financial Scorecard include a number of actions that will help Peel remain financially sustainable over the long term and maintain its strong credit rating.

APPENDICES

Appendix I – 2021 Financial Scorecard

For further information regarding this report, please contact Norman Lum, Director, Business & Financial Planning, 905-791-7800 Ext. 3567 or Norman.Lum@peelregion.ca.

Authored By: Norman Lum, Director, Business & Financial Planning

Reviewed and/or approved in workflow by:

Department Commissioner and Division Director.

Appendix I
2021 Update of the Region of Peel's Financial Condition

2021 Financial Scorecard

Region of Peel
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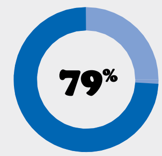
Summary of Financial Health

Financial Sustainability — Maintained services and infrastructure recognizing growing population and aging infrastructure.

Financial Vulnerability — Peel Region is highly vulnerable due to its extensive reliance on external funding. Provincial Funding was restrained in both 2019 and in 2020 increasing the property tax burden.

Financial Flexibility — Maintained and/or improved flexibility in 2020. Reserves were utilized for economic challenges; capital cash flow forecasting and debt leveraging were improved.

Focus GTA Spring 2020 Value for Tax Dollars



Credit Ratings

Aaa

AAA

Financial Principles	Indicator	Target	Performance	Risk Trend	Future Actions
Financial Sustainability					
Respect the taxpayer	**Net Tax Levy Increase**	1–3%	✓	Neutral	**Action:** 2022 budget to be developed recognizing evolving economy **Impact:** Respecting the taxpayer
Ensure the Capital Plan is sustainable Manage assets	**Capital Reserves as a % of 20 Year Capital Plan (tax and utility rates)**	100%	✗ Tax ✗ Utility	**Tax: Negative** **Utility: Negative**	**Tax Action:** 0.6% infrastructure levy in 2021 and 1% from 2022 to 2026 inclusive **Utility Action:** 5% infrastructure levy from 2021 to 2023 inclusive **Tax and Utility Impact:** Sufficient funds to meet State of Good Repair
Deliver value for money	**Asset Health Score**	Good	✓	Positive	**Action:** Mature Peel's asset management practice **Impact:** Realize greater asset value
Financial Vulnerability					
Users pay where appropriate	**Reduction in growth related risk**	Lower Debt vs Forecast	✓	Positive	**Action:** Implementing Peel's Growth Management Program **Impact** Lower the projected DC related debt
Work with local municipalities to manage growth and support economic viability of the community	**Reliance on external funding**	Funding meets Growth & Inflation	✗	Negative	**Action:** Assess impact of Provincial funding & support Council's advocacy efforts **Impact:** Meet service needs in Peel
	Proportion of non-residential tax revenue	35–45%	✓	Negative	**Action:** Support Council advocacy for diversified revenue tools **Impact:** Improved municipal fiscal sustainability
Make responsible investments	**Investment returns**	Above inflation	✓	Positive	**Action:** Continue to identify opportunities to add value and optimize returns **Impact:** Improved investment returns support funding of Peel's capital program
Financial Flexibility					
Mitigate significant fluctuations in tax and utility rates	**Debt capacity**	Below 25%	✓	Neutral	**Action:** Continue to monitor debt requirements and structure of debt program **Impact**: Maintain financial flexibility and sustainability while minimizing cost of borrowing
	Reserve adequacy	5-10%	✓ Tax ✓ Utility	**Tax: Positive** **Utility: Positive**	**Action:** In 2021, Council approved use of reserves to address economic challenges **Impact:** Support the residents and businesses
Borrow when appropriate for capital infrastructure	**Liquidity**	>120%	✓	Neutral	**Action:** Continue to hold appropriate levels of liquidity to meet operating and capital requirements **Impact:** Reduce financial risk of cash flow timing uncertainty