

NO: R141

COUNCIL DATE: July 22, 2024

REGULAR COUNCIL

TO: **Mayor & Council**

DATE: **July 18, 2024**

FROM: **General Manager, Finance**

FILE: **1880-20**

SUBJECT: **Quarterly Financial Report - Second 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 two quarters 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 two quarters of 2024, in comparison to the adopted Five-Year (2024-2028) Financial Plan.

Economic Environment and Key Economic Factors

International Overview

As inflationary pressures ease, central banks around the world have initiated the process of bringing down their benchmark interest rates. As expected, central banks are exercising caution by trimming interest rates in increments smaller than the pace at which rate hikes were implemented over the last two years. Central banks are not expected to reduce their benchmark rates at every interest rate meeting. Instead, it is expected that there will be periods where interest rates are kept on pause to allow decision makers to observe the effect of rate reductions and assess the effectiveness of their monetary policy adjustments. The United States ("US") Federal Reserve ("Fed") is expected to be amongst the last major central banks to cut interest rates with an adjustment not anticipated until the last quarter of this year.

The European Central Bank ("ECB") trimmed its benchmark rate by 0.25% in June. Headline inflation in the Eurozone came in at 2.5% at the end of the second quarter, while services inflation remains elevated at 4.1%. The ECB is forecasting inflation to return to its 2.0% target by the last quarter of 2025. The timing of the next rate cut by the ECB is uncertain as it needs to ensure

inflation is contained without pushing the economy into recession through overly restrictive policy changes. The ECB Chair stressed that future rate decisions will be based on incoming data.

The Bank of England (“BOE”) chose to keep its benchmark interest rate at 5.25% in June despite inflation reaching its targeted level of 2.0% in May of this year. Policy makers at the BOE are concerned that inflation will not remain at its targeted level if rates are trimmed too soon. The central bank cites high services inflation, 5.7% for May 2024, and strong wage growth as causes for concern. Analysts predict that the BOE will implement its first rate cut in August of this year, provided that July’s inflation report does not contain any upside surprises.

Although global central banks exercise autonomy in setting monetary policies, US policy makers are mindful of the impacts that Fed interest rate decisions have on the rest of the world’s economies. If the Fed delays rate cuts until the last quarter of 2024 as anticipated, the US dollar will appreciate relative to other currencies during the intervening period. Countries with US-dollar denominated debt will see higher borrowing costs along with higher import prices due to a weaker currency, increasing the risk of stoking inflation further.

United States Overview

The US economy and labour market remains strong despite higher borrowing costs and inflation. The US Federal Reserve kept its benchmark interest rate range at 5.25% - 5.50% at its June meeting, holding firm at this level since July 2023. Although inflation rates have steadily trended down, policy makers at the central bank expressed concerns that inflation remains elevated. This resiliency in the Consumer Price Index (“CPI”) has caused the Fed to trim its projected interest rate cuts from three to only one, anticipated later this year.

US inflation dropped to 2.6% in May 2024 after higher readings in March and April which caused the Fed to readjust the timing of expected interest rates cuts. The Fed reiterated that interest rates need to remain higher until the central bank is confident that inflation is returning to its targeted level. The Fed indicated that if the US job market begins to show weaknesses, then it may implement an interest rate cut even if the inflation rate is not yet at its targeted rate. The Fed Chair reiterated that trimming the key interest rate too soon may fuel inflation, while moving too late will undermine economic growth and recovery. Monetary policy makers continue to assess data and the broader economic landscape to aid them in determining the right balance and optimal timing of policy adjustments.

The US unemployment rate rose to 4.1% in June, the highest reading since October 2021, while the average hourly wage rate increased by 3.9%, compared to the prior year. The June job creation report came in slightly higher than economists’ expectations with 206,000 new jobs created. US Gross Domestic Product (“GDP”) grew by an annualized rate of 1.4% in the first quarter, with growth in the second quarter estimated at 1.5%. Based on recent data, some analysts are forecasting the Fed to cut interest rates as early as September, provided there is no further acceleration in inflation.

Uncertainty surrounds the looming US presidential election in November of this year. Rising uncertainty tends to foreshadow declines in investment, output, and employment. Analysts predict that heightened anxiety could lead to a softer second half of the year for the US economy and financial markets. Signs of headwinds are beginning to appear. Data on manufacturing activity, new orders, and service sector employment showed a slowdown in June.

Canadian Overview

The Bank of Canada (“BOC”) cut its benchmark interest rate by 0.25% in June, the first reduction in four years. The BOC Chair indicated that future interest rate cuts will be gradual and dependent on inflation and unemployment data evolving in the manner that the central bank expects to see. The BOC cautioned that, if progress on declining inflation stalls, it will pause on further interest rate cuts. The BOC’s key interest rate is expected to fall at a slower pace and settle at a higher level than before the pandemic.

Canada’s GDP grew by 0.30% in April and Statistics Canada estimates that the GDP increased by 0.10% in May. The Canadian economy shed 1,400 jobs in June which is well below economists’ expectation of 25,000 jobs gained. The unemployment rate edged up to 6.40%. The average hourly wage increased by 5.40% in June compared to the same month last year.

Canada’s inflation rate unexpectedly rose to 2.9% in May, increasing by 0.20% from the prior month. The rise in inflation was attributed to higher prices for services and shelter costs. The upside surprise in the CPI is the first increase this year, following months of softer inflation readings. June inflation data will be released prior to the next BOC meeting in July. If the inflation rate falls further, an interest rate cut by the central bank is still possible in the next meeting as GDP data shows the economy is slowing and unemployment rising, increasing the odds of another interest rate drop.

Although the BOC’s possible cut is not expected to have a major impact on the economy, it will provide some relief to households with variable rate loans. Many businesses and consumers are hopeful that this signals the beginning of an easing cycle. Based on the recent CPI and GDP announcements, analysts are forecasting up to two additional interest rate cuts this year.

The central bank Chair acknowledged that there is a limit to how far the BOC’s policy rate can diverge from the Fed’s. However, the BOC Chair indicated that, at this point in time, the central bank has not yet reached the limit where divergent policies would be a cause for concern.

Economists cite the Canadian dollar, housing market and wage growth as risks that could stall the BOC’s expected interest rate cuts. If the BOC and Fed’s policies become too divergent, the Canadian dollar could devalue causing imports to be more expensive. The Canadian dollar has held up well in recent weeks trading at 73.5 US cents per Canadian dollar. The Canadian housing market has not shown any signs of heating up. There is no appreciable increase in activity despite the recent relief, albeit modest, provided by the BOC’s June monetary policy adjustment.

British Columbia Overview

British Columbia’s (“BC”) unemployment rate came in at 5.2% in June, despite the economy shedding 9,700 jobs. One-third of the jobs lost were full-time positions. Job gains in the construction, wholesale and retail sectors were offset by losses in the healthcare and tech sectors.

BC’s inflation rate came in at 2.9% in May, driven by rising prices for services, gasoline and shelter. In May, BC’s shelter cost increased by 6.4% compared to the same month last year. Mortgage interest costs were up 23.3% and rents were higher by 8.6%.

The BC Real Estate Association reported that home sales have slowed down this year. May home sales fell by 11.6% compared to the prior year’s results. The total sales volume went down by 13.0% and

average residential sales were down 1.5% in May compared to the same month in the previous year. The recent key interest rate cut by the BOC is not expected to reignite housing sales as the still high benchmark interest rate, coupled with high sale prices of homes, are still keeping home ownership out of reach for many British Columbians.

The slowdown in home sales and buildup of housing inventory is expected to cause price growth to decelerate. A report by the Bank of Montreal (“BMO”) is projecting that housing affordability may return with falling interest rates, stable home prices and rising incomes. BMO cited other factors that may help with affordability, such as, recent changes in the federal government’s immigration policies and the provincial government’s changes to zoning policies. The BMO report outlines a potential path to return some affordability to BC’s housing market, however, these improvements will likely take time to materialize.

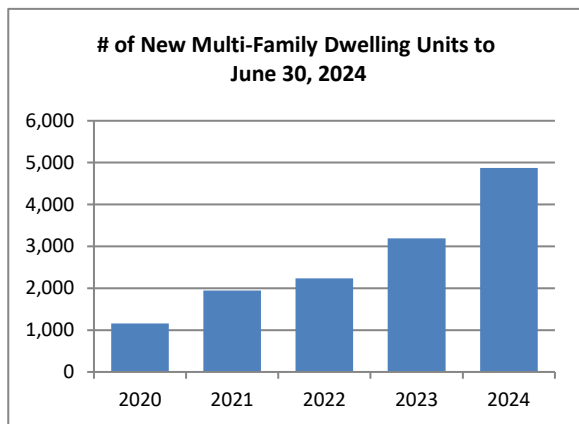
City of Surrey Overview

In Q1/Q2 2024, the City experienced a surge in the issuance of building permits due 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 meet this deadline to mitigate the financial impact of the Metro Vancouver DCC rate change on their projects. This directly triggered an increase in the volume of permits issued by the City in this six-month period. As highlighted in the graphs in the following section, this has resulted in significant increases in the values of construction related to the multi-family residential and Industrial, Commercial & Institutional (“ICI”) development segments, substantially surpassing figures from previous years.

Overall, in the residential development category, the City has seen a 68% increase in the value of construction of residential building permits, primarily due to a significant increase in new multi-family development activity, offset by a slowdown in single-family permits.

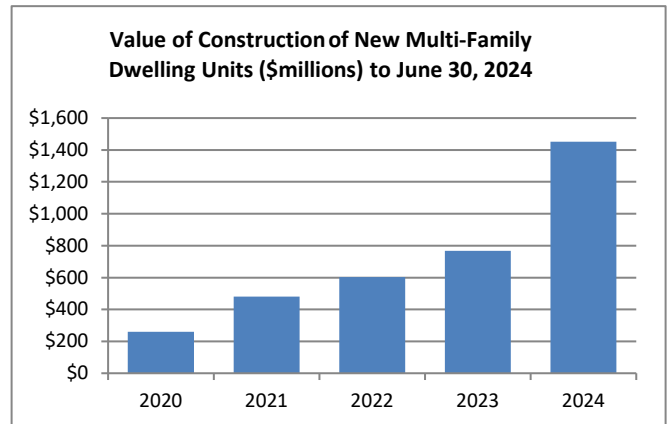
City of Surrey’s Key Performance Indicators

The following graphs show data for the first six 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 2024. This six-month

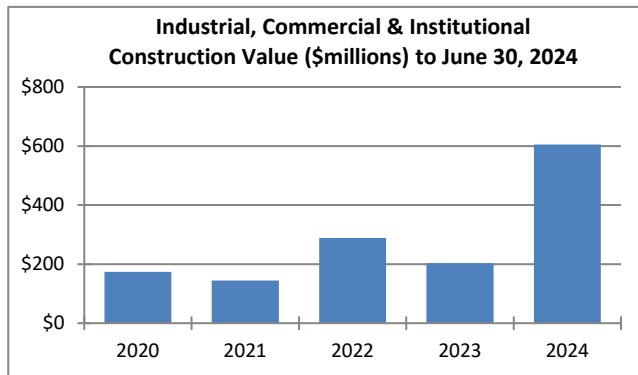


Graph 2

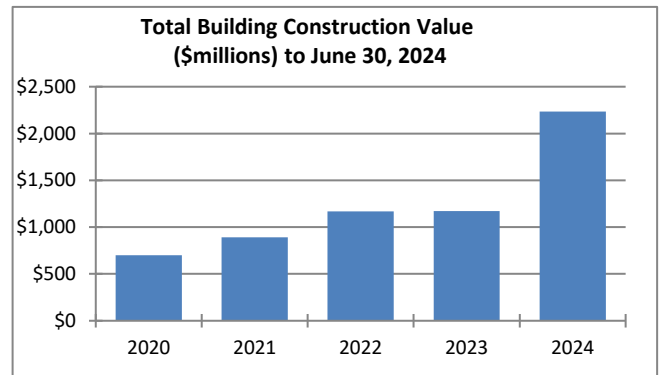
Consistent with the increase in the number of permits for new multi-family dwelling units in this period as compared to the same period last year, the value of construction for these units has

period has seen an increase in permits for multi-family dwelling units by 53%.

increased by 89% when compared to the same period last year.



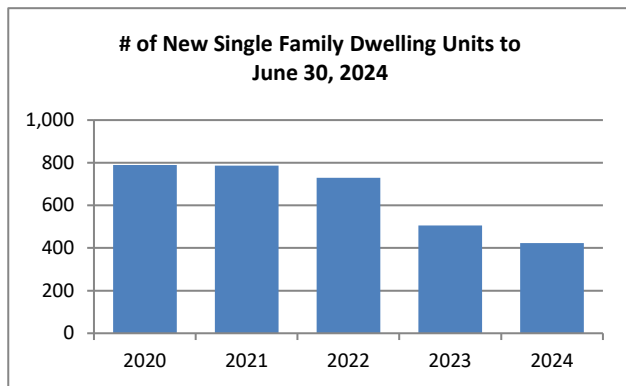
Graph 3



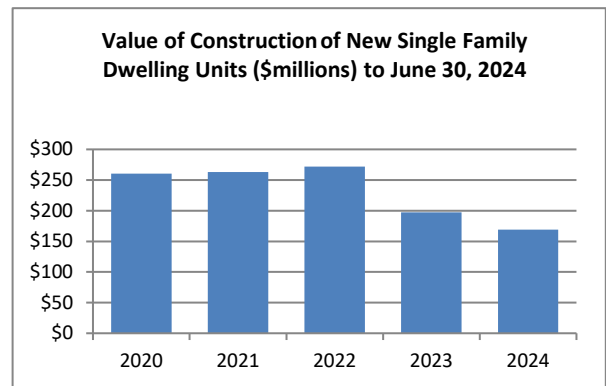
Graph 4

Construction value of ICI permits for the first six months of 2024 is higher by 198% as compared to the same period in 2023. This is primarily due to some significant projects that received permits in this period in 2024, including two large industrial warehouse projects in Cloverdale and Campbell Heights.

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, total building construction value in the City year-to-date is higher by 91% compared to the same period last year.



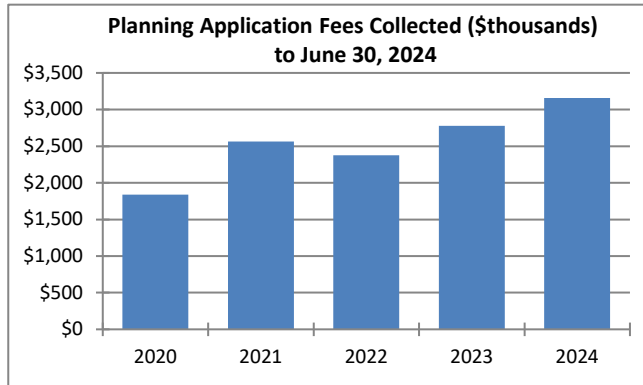
Graph 5



Graph 6

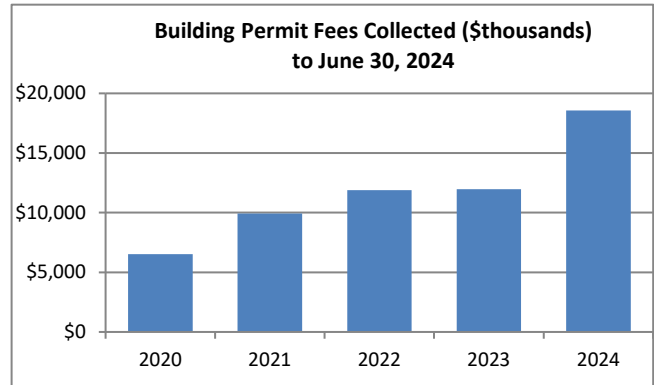
Due to a continued shift in residential development activity from single-family to multi-family, new Single Family Dwelling units have declined by 16% in this six-month period, as compared to the same period in 2024.

Due to a decline in the number of new single-family dwelling unit permits issued in this six-month period as compared to the same period last year, the value of construction of these units has correspondingly decreased by 15% when compared to the same period last year.



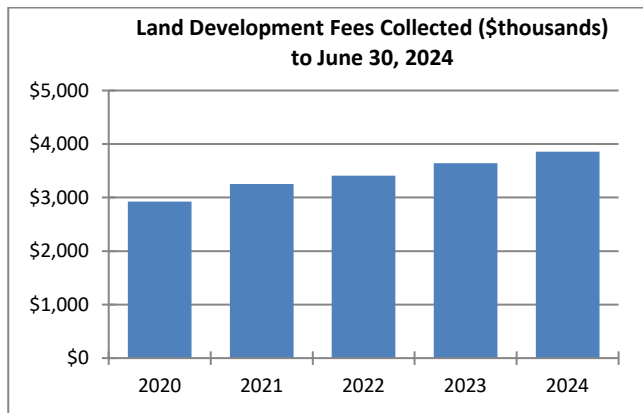
Graph 7

Although the first three months of the year saw a slight slowdown in planning activity, primarily due to uncertainties around the timing of Bank of Canada interest rate reductions, the last three months in this period have seen an uptick in overall planning activity, resulting in an overall increase of 14% over the same period last year.



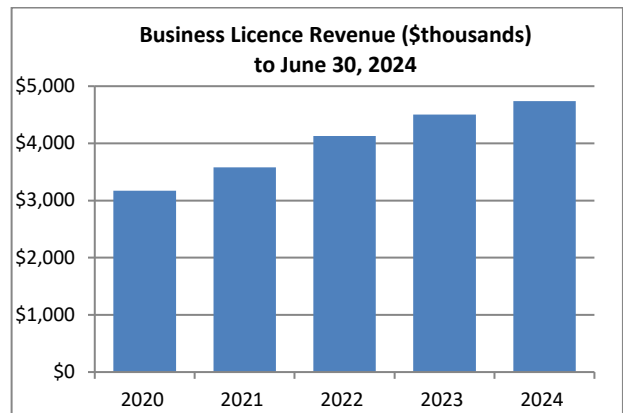
Graph 8

Since total building construction value in the City has significantly increased as compared to the same period last year (as reflected in Graph 4), building permit fees collected in this six-month period as compared to the same period last year have increased by 55%.



Graph 9

In alignment with Planning Application fees, Land Development fees collected for the first six months of 2024 are higher by 6% as compared to the same period in 2023.

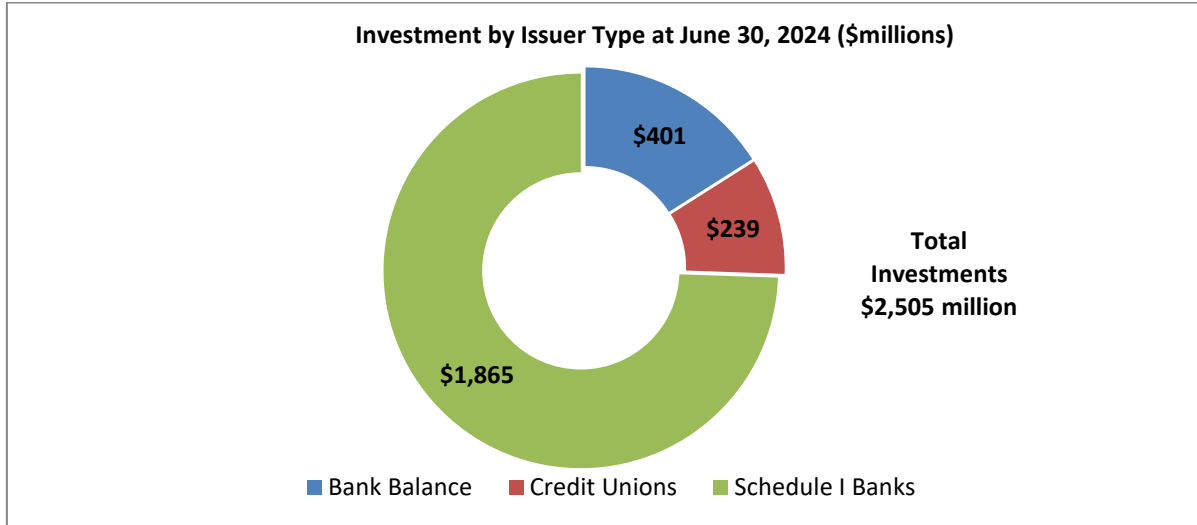


Graph 10

Consistent with increases over the last few years, business licence revenue in the first six months of 2024 increased by 5% as compared to the same period last year. This increase aligns with the increase in the number of businesses paying for business licences in Surrey in this six-month period as compared to 2023.

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 \$2,505 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.



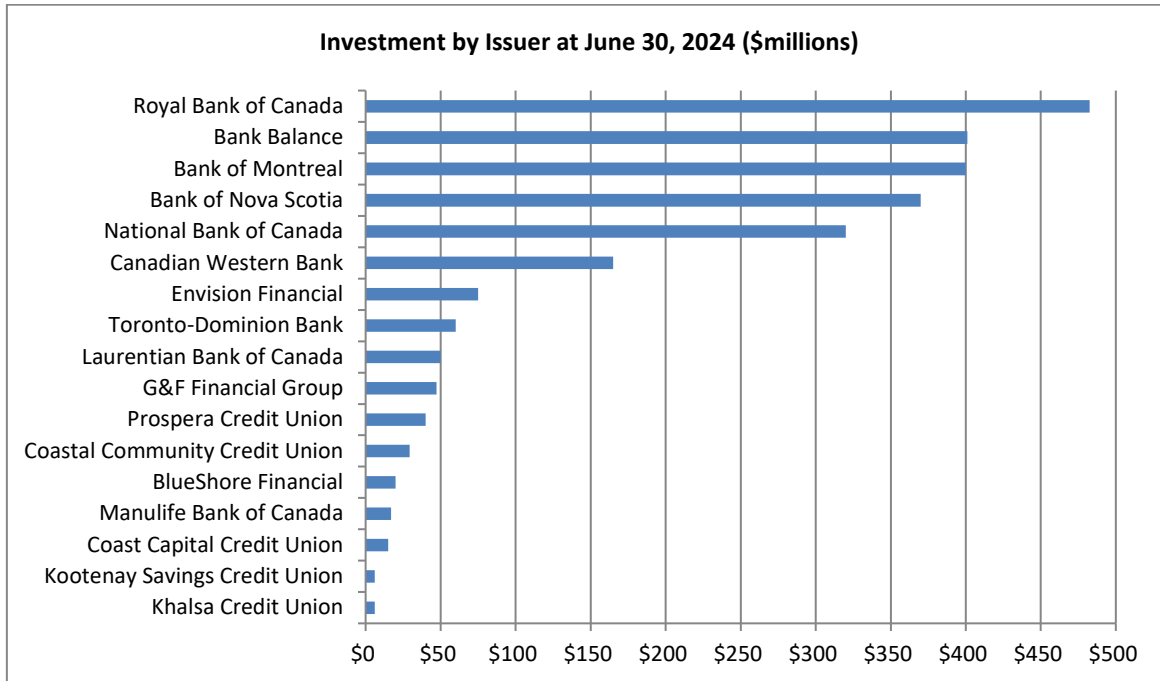
Graph 11

Investments within the portfolio are managed within the framework of the City’s Investment Policy.

Objectives of the Policy include the following:

Diversification

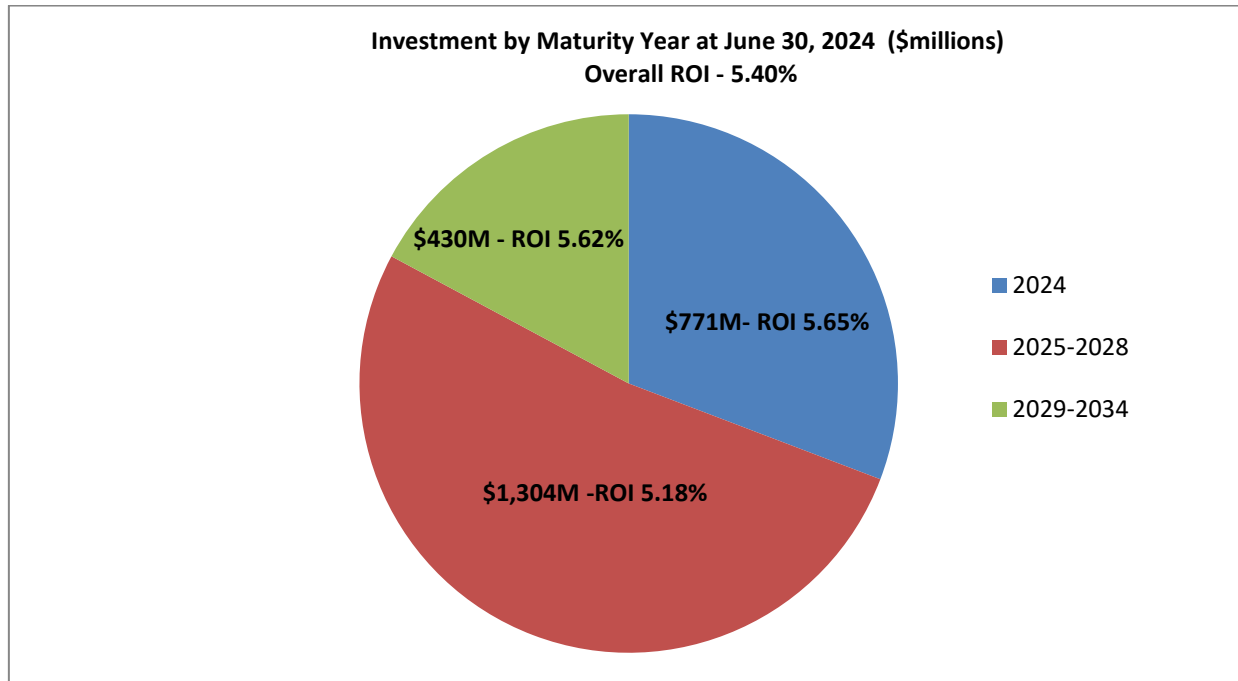
In order to reduce overall portfolio risk, the City diversifies its investment holdings across a range of security types and financial institutions. Graph 12 shows a listing of the City’s portfolio by Financial Institution.



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.



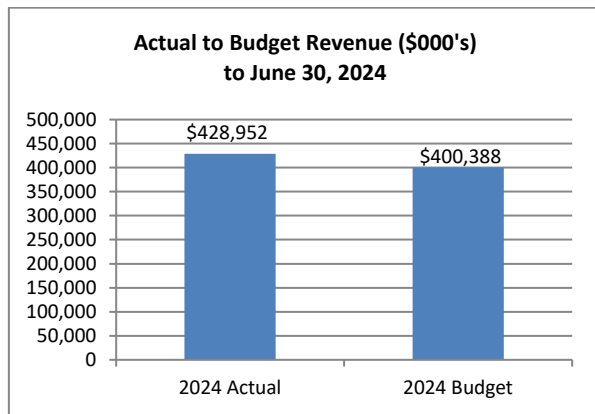
Graph 13

Return on Investment

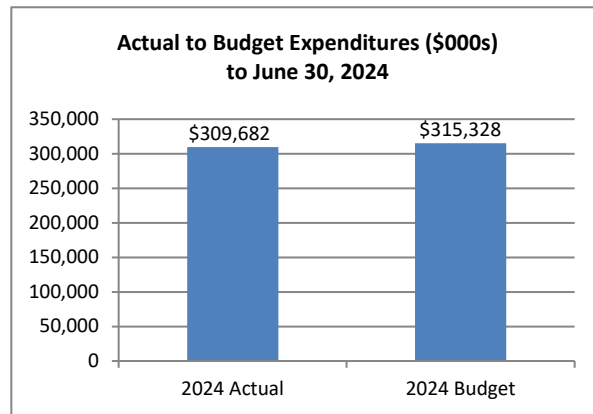
The City strives to earn a reasonable rate of return on the investment portfolio throughout varying budgetary and economic cycles, taking into account investment risk constraints and liquidity needs. During the six-month period ending June 30, 2024, the City's investment portfolio earned a combined rate of approximately 5.40% (during the six-month period ending June 30, 2023 - 4.20%) while maintaining investment security as outlined in the City's investment policy.

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 two quarters of 2024.



Graph 14



Graph 15

Appendix “I” documents the General Operating Fund’s revenues and expenditures at the end of the second 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”.

Policing 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 \$221.6 million was approved by Council to provide sufficient funding to ensure adequate and effective policing in Surrey.

On April 23, 2024, the Province announced a transition date of November 29, 2024, for SPS to become the Police of Jurisdiction (“POJ”). On July 10, 2024, the BC government and the City of Surrey reached an agreement that will complete the transition to the SPS by providing oversight, accountability and cost mitigation for residents and businesses in Surrey. Through the agreement, the Province will provide \$30 million per year to assist with transition costs until 2029. The agreement also provides a financial guarantee of as much as \$20 million per year if SPS salary costs are higher than estimated RCMP costs, from 2029 to 2034 for actual costs. This funding from the Province will help to lessen the financial impact of the transition on Surrey taxpayers.

In relation to the adopted Q2 budget for Policing Services, the following is the variance for each of the components:

- **Police Services** currently is on budget.
- **City Police Support Service** currently has a favourable variance of \$0.13 million, primarily due to revenues from Police Information Checks being higher than the budget. City Police Support Service is currently forecasting to have a favourable variance at year end of \$1.13 million.

Fire Department currently has a favourable variance of \$1.53 million, primarily due to timing of the hiring of 20 approved new Fire personnel positions in 2024. Fire is currently forecasted to have a favourable variance at year end of \$1.69 million.

Engineering Services - General Operating currently has a favourable variance of \$1.58 million, primarily due to higher-than-expected land development revenues, staff vacancies and timing of operating costs and are forecasted to have a favourable variance at year end of \$1.85 million.

Parks, Recreation & Culture (“PRC”) Department currently has a favourable variance of \$2.86 million. This is primarily due to vacancies and timing of expenditures and higher than expected facility rental revenues and unbudgeted grants received from another level of government. At this point, staff are forecasting a favourable variance for PRC at year end of \$0.53 million.

Planning & Development Department currently has a favourable variance of \$3.38 million. This is attributable to a surge in the issuance of building permits in the first two quarters, 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. Due to such a significant variance in this six-month period, staff are forecasting a favourable variance at year end of \$6.90 million.

Surrey Public Library currently has a favourable variance of \$0.71 million, due to timing of operating costs and savings from vacancies. Staff are forecasting that Surrey Libraries will be on budget at year end.

Mayor and Council currently has a favourable variance of \$0.02 million and is expected to have a variance of \$0.05 million at year end.

City Grants currently have a favourable variance of \$0.22 million and are expected to be on budget at year end.

City Manager’s Department currently has a favourable variance of \$0.29 million primarily due to the timing of expenditures and are expected to have a variance of \$0.24 million at year end.

Corporate Services Department has a favourable variance of \$2.0 million due to better-than-expected business license revenues, timing of operating costs and savings from vacancies and is forecasted to have a favourable variance at year end of \$1.13 million.

Finance Department currently has a favourable variance of \$0.82 million, primarily due to timing of operating costs and savings from vacancies and is forecasted to have a favourable variance at year end of \$1.96 million.

Social Infrastructure & Community Investment currently has a favourable variance of \$1.44 million, primarily due to savings from vacancies and timing of expenditures and is forecasted to have a favourable variance at year end of \$1.05 million.

CONCLUSION

City departments continue to proactively manage their respective budgets to ensure the financial position of the City for the remainder of the year remains strong and the City collectively meets budget at year end.

Kam Grewal
CFO / General Manager
Finance

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

Appendix "I"

2024 2nd QUARTER COUNCIL REPORT EXECUTIVE SUMMARY - REVENUES & EXPENDITURES \$ 000's

REVENUE SUMMARY	2024: 2nd Qtr YTD Actual	2024 YTD BUDGET	2024: 2nd Qtr YTD Variance	2024 ANNUAL FORECAST	2024 ANNUAL BUDGET	2024 Projected Variance
Net Taxation	289,760	280,660	9,100	552,234	543,134	9,100
Secondary Suite Infrastructure Fee	19,377	18,221	1,156	35,397	34,116	1,281
Other Corporate Fees	2,196	2,281	(86)	4,066	4,066	-
Investment Interest	39,778	33,929	5,849	77,957	70,608	7,349
Provincial Casino Revenue Sharing	1,637	1,637	-	3,273	3,273	-
Local Govt. Climate Action Program	3,443	3,443	-	3,443	3,443	-
Other Trsf from Government	3,022	-	3,022	45,705	42,683	3,022
Penalties & Interest on Taxes	689	353	336	7,514	7,000	514
Corporate Leases	5,800	5,714	86	14,020	13,925	95
Non-Tax Revenues	75,941	65,578	10,363	191,374	179,114	12,260
Program Revenues	63,251	54,150	9,101	121,153	104,753	16,400
TOTAL REVENUES	428,952	400,388	28,564	864,761	827,001	37,760
EXPENDITURE SUMMARY	2024: 2nd Qtr YTD Actual	2024 YTD BUDGET	2024: 2nd Qtr YTD Variance	2024 ANNUAL FORECAST	2024 ANNUAL BUDGET	2024 Projected Variance
Program Expenditures, net of transfers	300,131	306,025	5,894	643,983	644,118	135
Council Priorities	162	162	-	260	260	-
Fiscal Services	310	62	(247)	420	125	(295)
Debt Interest & Principal	7,285	7,285	-	18,719	18,719	-
Other	1,795	1,795	-	26,442	26,442	-
TOTAL EXPENDITURES	309,682	315,328	5,647	689,824	689,664	(160)
CORPORATE TRANSFER SUMMARY	2024: 2nd Qtr YTD Actual	2024 YTD BUDGET	2024: 2nd Qtr YTD Variance	2024 ANNUAL FORECAST	2024 ANNUAL BUDGET	2024 Projected Variance
Transfer to /(from) Operating Sources	(10,217)	(10,181)	36	(20,397)	(20,361)	36
Transfer to /(from) Capital Sources	261	-	(261)	522	-	(522)
Transfer to /(from) Reserve Sources	4,707	4,707	-	33,800	33,800	-
Transfer to /(from) Surplus	65,683	65,910	227	123,410	123,898	488
TOTAL TRANSFERS	60,433	60,436	3	137,335	137,337	2
Surplus (Deficit)	58,837	24,624	34,213	37,602	-	37,602
Trsf (To)From Unapprop Surplus	(58,837)	(24,624)	(34,213)	(37,602)	-	(37,602)
BALANCED BUDGET	-	-	-	-	-	-
2nd Quarter YTD Actual to Budget Variance:			\$ 34,213			

Appendix "II"

**2024 2nd QUARTER COUNCIL REPORT
DEPARTMENTAL DETAIL
\$ 000's**

	2024: 2nd Qtr YTD ACTUAL	2024 YTD BUDGET	2024: 2nd Qtr YTD Variance	2024 Projected ACTUAL	2024 ANNUAL BUDGET	2024 Projected Variance
PROGRAM REVENUES						
City Police Support Service	5,343	4,569	774	9,011	8,437	574
Police Services	-	-	-	-	-	-
Fire	1,039	592	446	5,461	5,015	446
Engineering Services	6,546	5,679	867	11,738	10,566	1,172
Parks, Recreation & Culture	21,012	18,342	2,669	41,331	36,774	4,557
Planning & Development	20,240	17,526	2,714	37,059	29,847	7,212
Surrey Public Library	847	742	105	1,614	1,475	139
Mayor & Council	-	-	-	-	-	-
City Grants	-	-	-	-	-	-
City Manager	-	-	-	-	-	-
Corporate Services	6,354	5,963	391	12,205	11,126	1,079
Finance	733	737	(4)	1,499	1,513	(14)
Social Infrastructure & Community Invest.	1,137	-	1,137	1,233	-	1,233
TOTAL PROGRAM REVENUES	63,251	54,150	9,101	121,153	104,753	16,400

	2024: 2nd Qtr YTD ACTUAL	2024 YTD BUDGET	2024: 2nd Qtr YTD Variance	2024 Projected ACTUAL	2024 ANNUAL BUDGET	2024 Projected Variance
PROGRAM EXPENDITURES NET OF TRANSFERS						
City Police Support Service	17,081	16,435	(645)	36,262	36,817	555
Police Services	104,971	104,971	-	221,575	221,575	-
Fire	40,740	41,825	1,085	91,528	92,767	1,239
Engineering Services	6,264	6,981	717	14,285	14,962	677
Parks, Recreation & Culture	55,382	55,572	191	120,588	116,565	(4,023)
Planning & Development	13,097	13,762	666	27,890	27,580	(310)
Surrey Public Library	11,634	12,242	607	24,198	24,059	(139)
Mayor & Council	1,116	1,139	23	2,235	2,287	52
City Grants	1,047	1,268	221	1,611	1,611	-
City Manager	4,581	4,869	288	9,519	9,759	240
Corporate Services	35,617	37,233	1,617	74,736	74,788	52
Finance	5,016	5,837	821	10,376	12,350	1,974
Social Infrastructure & Community Invest.	3,586	3,890	304	9,180	8,998	(182)
TOTAL PROGRAM EXPENDITURES	300,131	306,025	5,894	643,983	644,118	135

	2024: 2nd Qtr YTD ACTUAL	2024 YTD BUDGET	2024: 2nd Qtr YTD Variance	2024 Projected ACTUAL	2024 ANNUAL BUDGET	2024 Projected Variance
NET PROGRAM						
City Police Support Service	11,738	11,867	129	27,251	28,380	1,129
Police Services	104,971	104,971	-	221,575	221,575	-
Fire	39,701	41,233	1,532	86,066	87,752	1,686
Engineering Services	(282)	1,302	1,584	2,546	4,396	1,850
Parks, Recreation & Culture	34,370	37,230	2,860	79,257	79,791	534
Planning & Development	(7,143)	(3,764)	3,379	(9,169)	(2,267)	6,902
Surrey Public Library	10,787	11,500	713	22,584	22,584	-
Mayor & Council	1,116	1,139	23	2,235	2,287	52
City Grants	1,047	1,268	221	1,611	1,611	-
City Manager	4,581	4,869	288	9,519	9,759	240
Corporate Services	29,263	31,270	2,007	62,531	63,662	1,131
Finance	4,283	5,100	817	8,877	10,837	1,960
Social Infrastructure & Community Invest.	2,449	3,890	1,441	7,947	8,998	1,051
NET PROGRAM TOTAL	236,880	251,875	14,995	522,830	539,365	16,535