Memo

Date: April 29, 2021

To: Audit Committee

From: Financial Services Divisional Director

Subject: 2020 City of Kelowna Financial Health Indicators

Report Prepared by: Corporate Finance Manager

Purpose:

To provide the Audit Committee with a report using key performance indicators that shows the overall financial health of the City for the year ended 2020. The report also provides comparative financial information for the year ended 2019 using Local Government data for Municipalities with greater than 100,000 population and for Local Governments in the region. Comparative financial information for 2020 will be available when the Local Government Data Entry (LGDE) statistics are published in the fall.

Background:

The Financial Services Division 2019-2023 Strategic Plan and the Council adopted Principles and Strategies for Financial Strength and Stability focus on strong financial stewardship. The Council adopted Principles and Strategies for Financial Strength and Stability is used to guide decision-making within the City and to help realize financial goals and, ultimately, the vision for Kelowna.

The principles and strategies guide the development of detailed policies, setting boundaries for budgeting and planning decisions. Performance measures and Financial Reporting are the essential communication tools that tell us how the City is performing year to year.

The City also compares our performance to other Municipalities and the Okanagan region. These comparative figures were taken from provincially provided LGDE reports. The ratio analysis focuses on the 10 BC Municipalities with a population of greater than 100,000 (Abbotsford, Burnaby, Coquitlam, Delta, Langley, North Vancouver, Richmond, Saanich, Surrey and Vancouver) and the Okanagan Region (Kamloops, Penticton, Vernon and West Kelowna).

2020 Comparative figures for other local governments will be available in the fall of 2021 and will be included at next year's Audit Committee meeting.

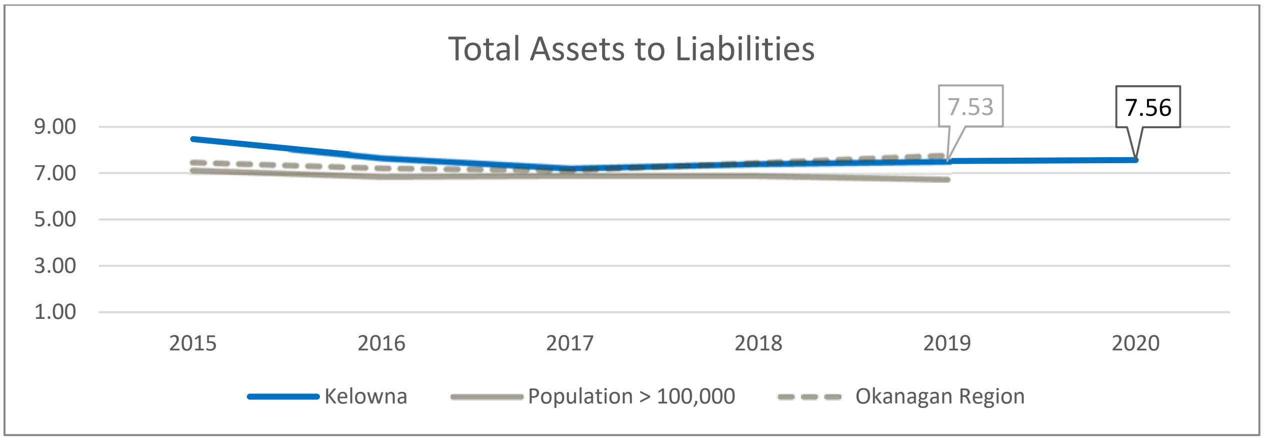
The Financial Health indicators outlined in this report provide a way to measure how decisions made during the year have affected the sustainability, flexibility and vulnerability of the City. They also link the financial results to the overall economic and fiscal environment that the City operates in.

Financial Health Indicators:

<u>Sustainability Ratios</u> – Measure the degree to which a Municipality can maintain its existing financial obligations without increasing the debt or tax burden relative to the economy in which it operates.

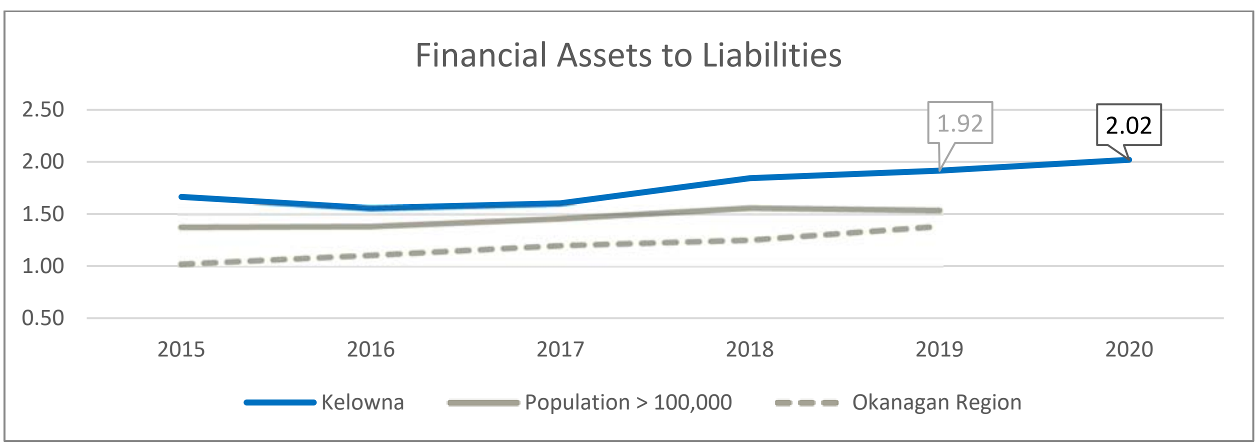
Indicator 1: Total Assets to Liabilities

This ratio measures the extent to which a government finances its operations and capital purchases through issuing debt, development cost charges and collecting deferred revenue. A higher total assets to liabilities ratio indicates the City is using financing options in a responsible and sustainable manner. The City's ratio remains steady in 2020 as both assets and liabilities increased at a comparable rate from 2019.



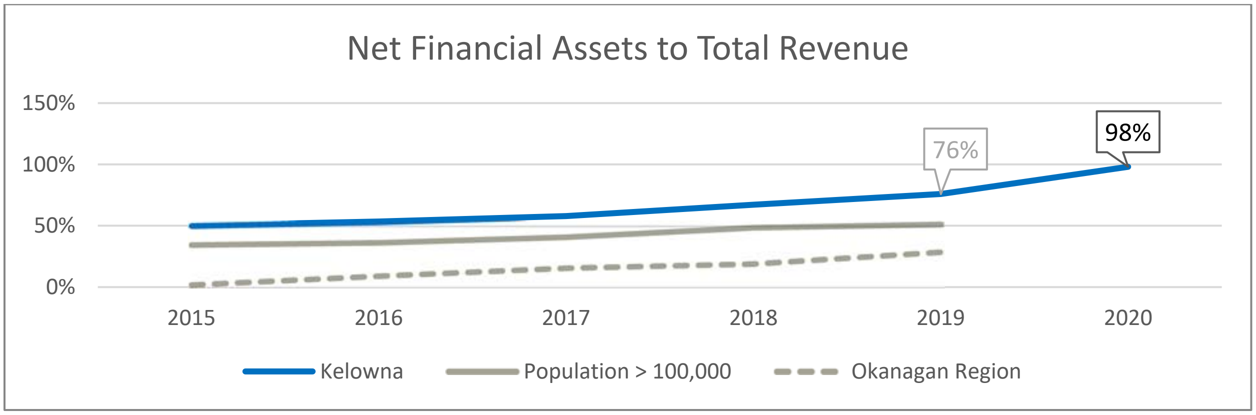
Indicator 2: Financial Assets to Liabilities

Measures liquidity and the City's ability to meet financial obligations. A ratio > 1.0 indicates the City is well positioned to meet its financial obligations without the need to fund past expenditures with future revenues. This ratio has been trending upwards in recent years, with financial assets growing at a greater rate ($47.7M) than that of financial liabilities ($7.6M), driven mostly by the increase in cash and short-term investments.

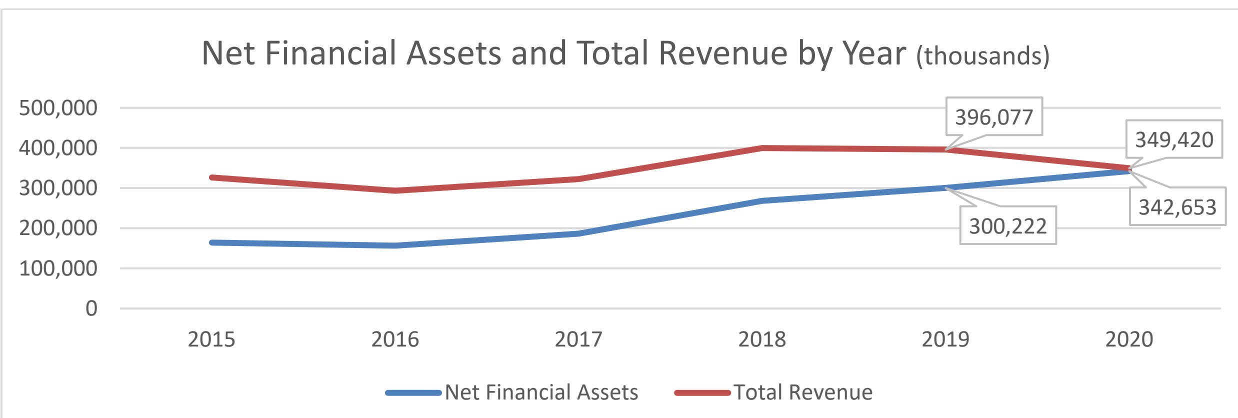


Indicator 3: Net Financial Assets (Financial Assets-Liabilities) to Total Revenue

This ratio provides a measure of revenue that can be used to fund current and future expenditures*. An increasing ratio normally indicates stability and that the City is well positioned to meet its financial obligations now and in the future. In this case, the increase from 76% in 2019 to 98% in 2020 was driven mostly by decreasing revenue, rather than an increasing rate of growth in net financial assets. The increase from 2019 to 2020 is due to an increase in net financial assets of $40.0M over prior year, and a decrease in revenue of $44.4M.

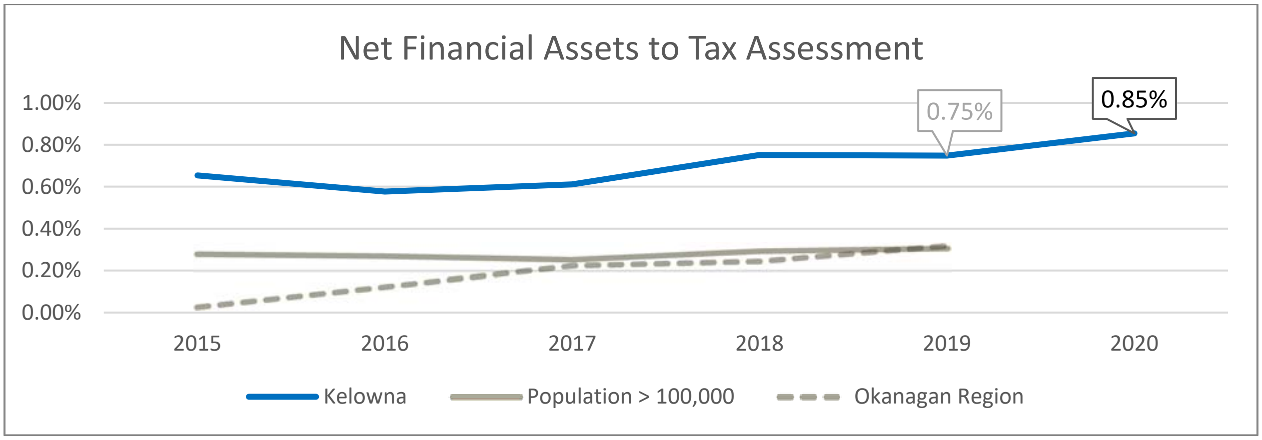


*This measure assumes stable or increasing revenue year over year. The increase in this ratio for 2020 was a result of decreasing non-tax revenues, primarily driven by COVID-19. As shown in the chart below, revenues decreased from 2019, while net financial assets continued to increase at a normal rate.



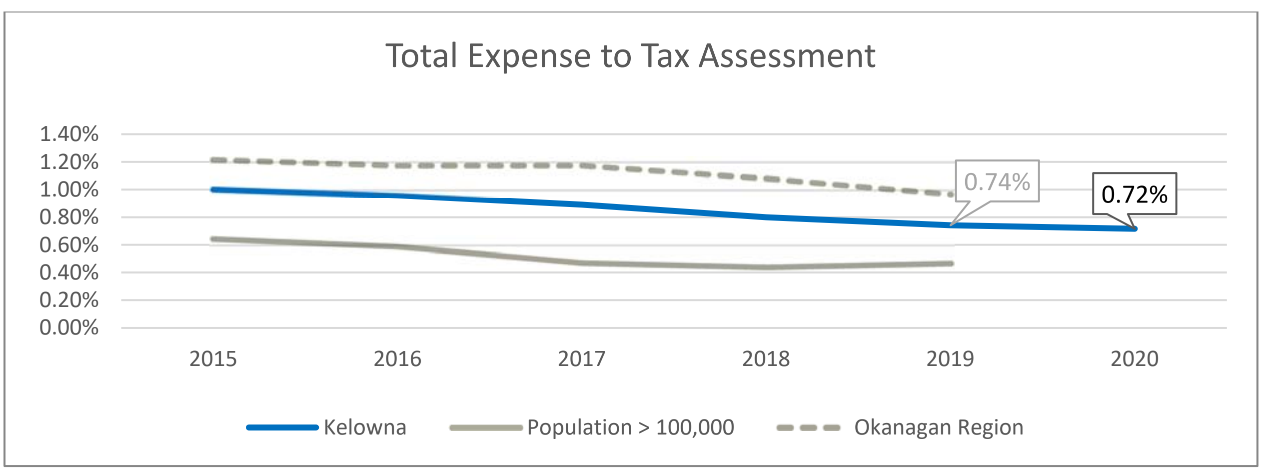
Indicator 4: Net Financial Assets (Financial Assets-Liabilities) to Tax Assessment

Measures the amount of available operating assets to cover future obligations relative to the change in the economy measured through the tax assessment. The relative stability in the graph from 2018-2019 shows that the City's net financial assets increased at rate comparable to that of the economy (as approximated by the change in the tax assessment amount). In 2020 the graph shows that growth in the City's Net Financial Assets increased at a greater rate than that of the economy due to a combination of an increase in investments, and a reduction in long term debt. It also shows that as of December 31, 2019 the City has more net financial assets per tax assessment dollars than the other Municipalities. The increase from 2019 to 2020 was due to financial assets increasing at a greater rate than tax assessment values.



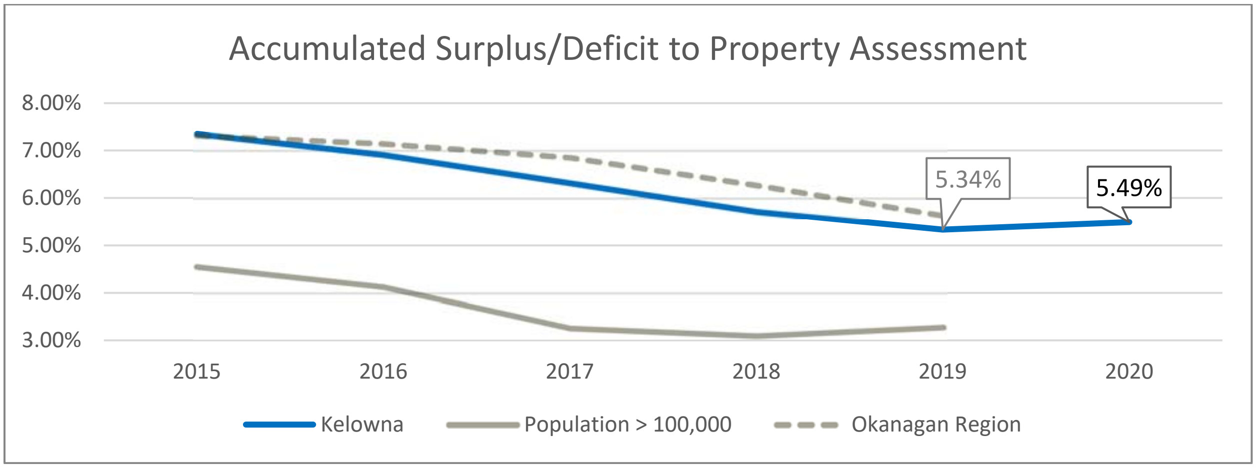
Indicator 5: Total Expense to Tax Assessment

Measures the ratio of spending relative to the tax base and the efficiency with which the City leverages increasing tax revenues. For 2020 this graph shows that the City's expenses remained relatively constant to the tax assessment and aligned with the change in the economy. It also shows that expenses were higher per assessment for the City than those for other Municipalities with populations greater than 100,000. The ratio remains relatively stable with a slight decrease into 2020 due to a 3% decrease in expenses over prior year, while property tax assessment increased by 2%.



Indicator 6: Accumulated Surplus/Deficit to Tax Assessment

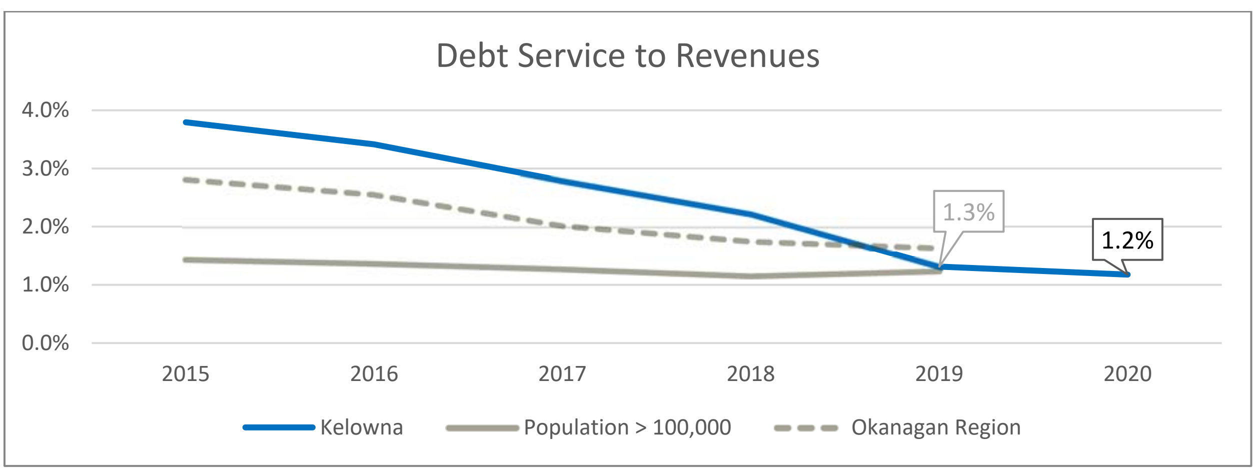
Measures the total economic resources available to provide future operations relative to the change in the economy measured through the change in tax assessments. After several years of downward trends, 2020 shows the City's accumulated surplus growing at a rate slightly faster than the economy. The difference between the City and Municipalities over 100,000 shows that the City's surplus compared to tax assessment is higher by 2-3% during the time frame.



<u>Flexibility Ratios</u> – Measure the degree to which a Municipality can change its debt or tax burden on the economy in which it operates to meet its existing financial obligations.

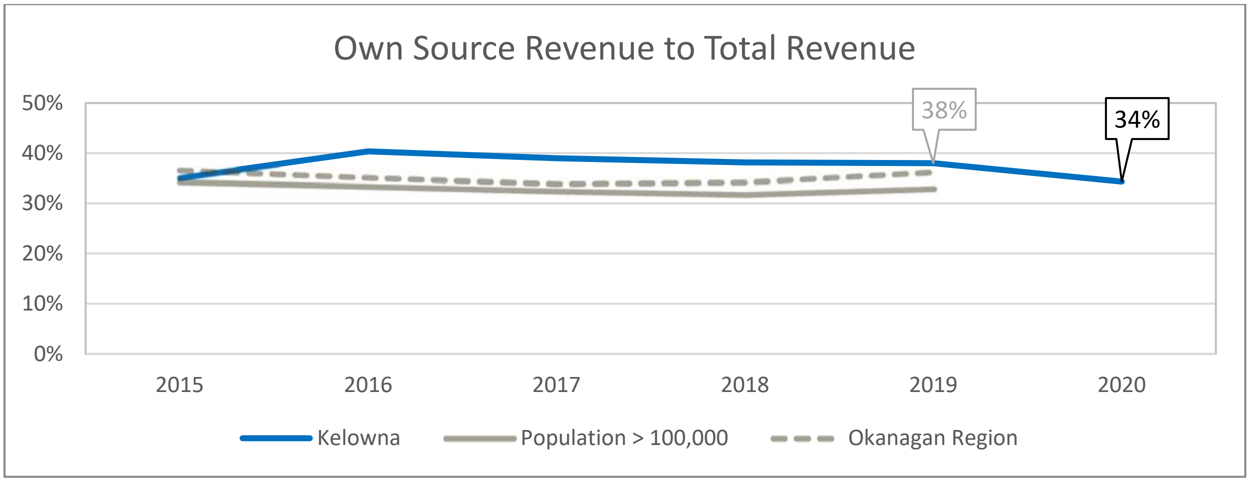
Indicator 7: Debt Service to Revenues

This ratio measures the percentage of current revenues required to service debt incurred to fund past expenditures and the capacity for the City to incur additional debt. A smaller debt service to revenue ratio indicates that the City has greater flexibility in future borrowing decisions and more revenue to use for other opportunities. The graph shows that in 2019 1.3% of revenues were used to pay for debt service charges and that the amount remained relatively steady in 2020 at 1.2%. The graph also shows that the City's borrowing ratio is currently in line with other municipalities.

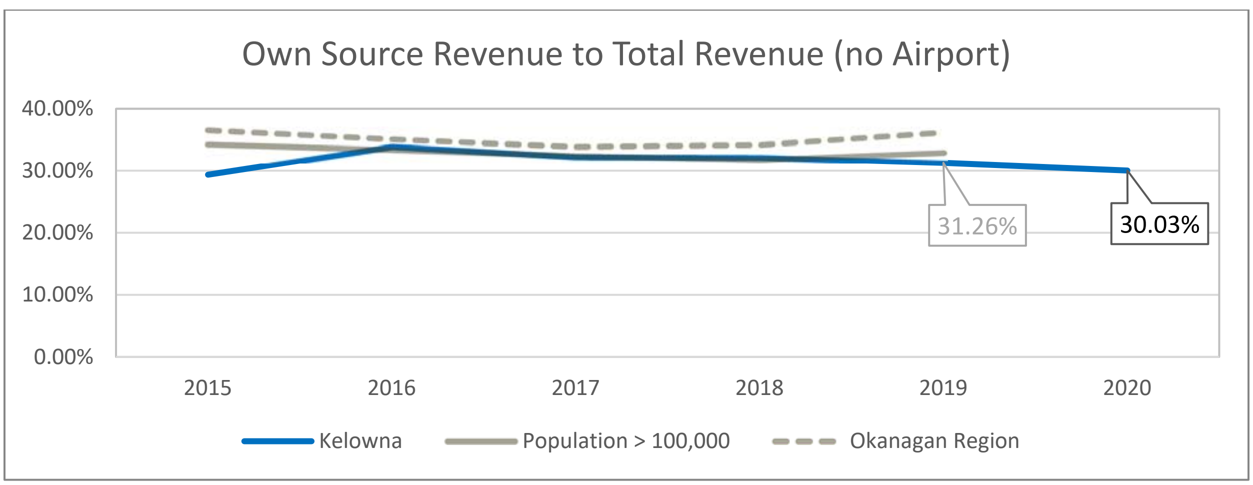


Indicator 8: Own Source Revenue to Total Revenue

Measures the extent to which own source revenues make up total revenues. This is a gauge for how much flexibility the City has to deal with changing revenue sources. For 2018 and 2019 this graph shows that sale of services revenues consistently made up 38% of total revenues. In 2020 this ratio decreased to 34% as many sources of non-tax revenue decreased due to COVID-19 public health restrictions and travel advisories resulting in decreases in air travel, public transit, and use of recreational facilities.

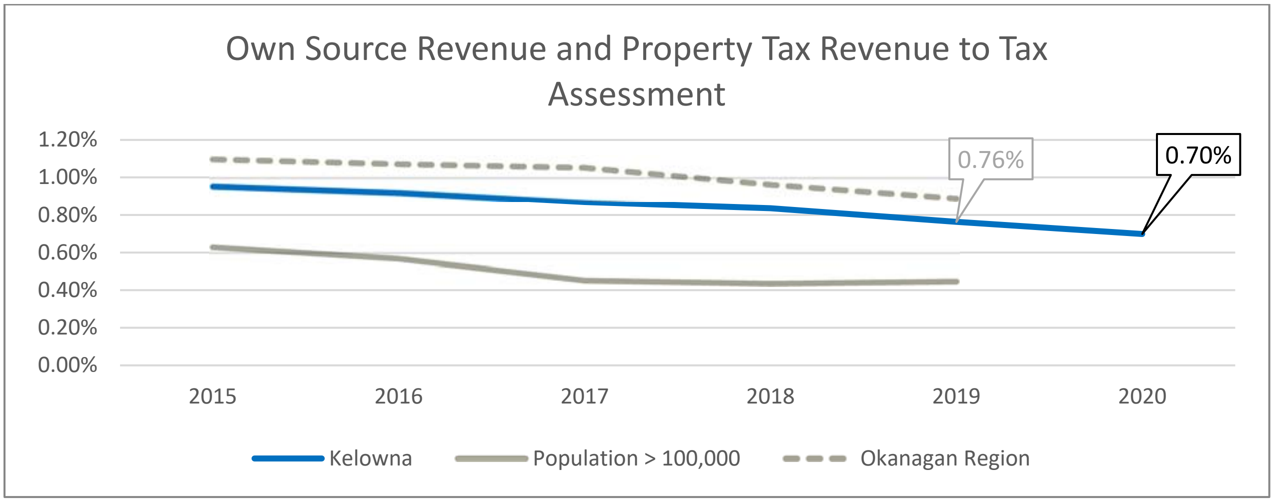


The graph below shows the same data, but with airport revenue removed. This measure gives a clearer comparative ratio as most British Columbia municipalities do not have a city-owned airport or the associated airport revenue. While we still see a small decrease from 2019 to 2020, the effect is much less pronounced than that in the chart above. The small decrease below is primarily due to the completion of the SEKID project and the associated decrease in grant revenue tied to that project.



Indicator 9: Own Source Revenue and Property Tax Revenue to Tax Assessment

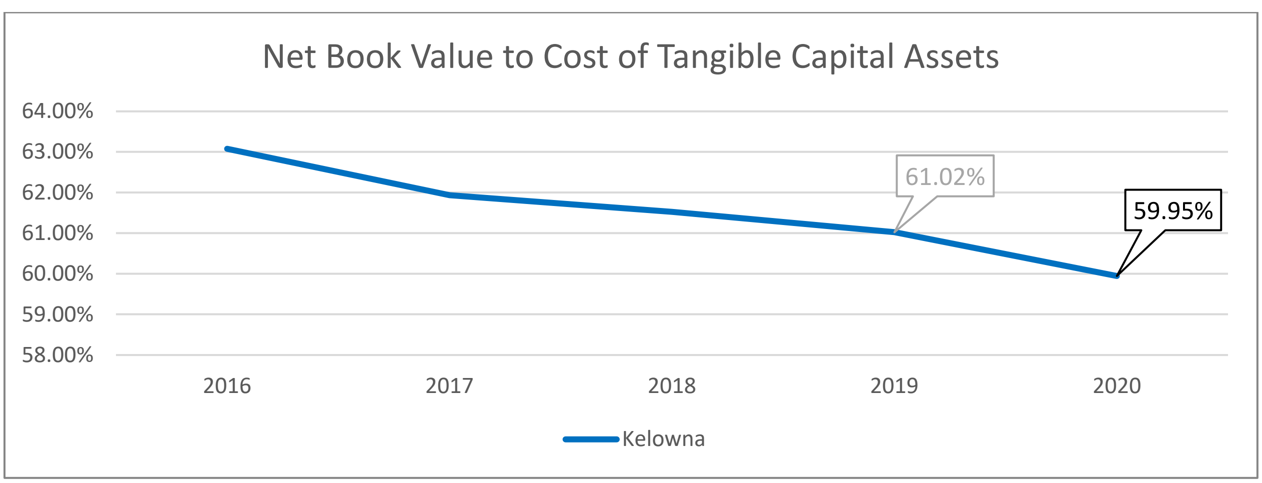
Measures the extent to which the City is taking income out of the economy either through taxation or user fees. For 2020 this graph shows that the City receives $0.70 from own source revenue per $1 of tax assessment. It also shows that the City receives more from own source revenues than Municipalities of a similar size and less than other Municipalities in the region as of December 31, 2019. The ratio declined slightly in 2020 due to decreases in own source revenue mentioned in the previous indicator.



Indicator 10: Net Book Value to Cost of Tangible Capital Assets

Measures the estimated useful life of the City's tangible capital assets available to provide products and services. A larger ratio indicates newer tangible capital assets, or a more frequent replacement rate. A smaller ratio indicates older tangible capital assets and may indicate that greater capital expenditures may be required for replacement. For 2020 this graph shows that tangible capital assets have 59.95% of their original cost left to be depreciated, or that the City has used 40.05% of its assets useful life.

Comparative information for this graph is not available as this data is not reported in the LGDE statements.

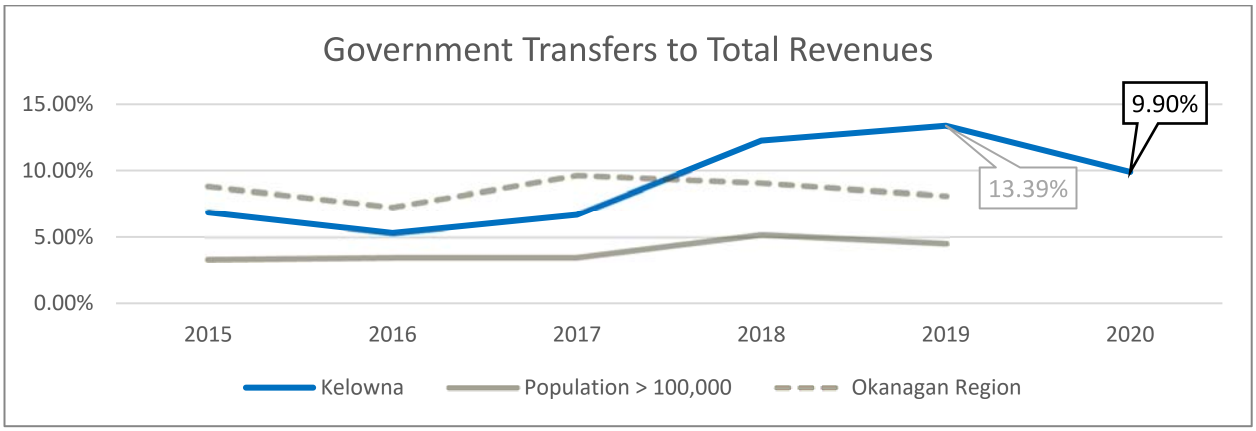


<u>Vulnerability Ratio</u> – Measures the degree to which a Municipality is dependent on sources of funding outside its control or influence or is exposed to risks that could affect its ability to meet existing financial obligations.

Indicator 11: Government Transfers to Total Revenues

This ratio measures the dependence of the City on other levels of government for sources of funding. It is important to note that a balance needs to be achieved as a reduced dependence on government transfers may reduce vulnerability but it could also impair sustainability if the City's tax base has to replace the revenues lost from a reduction in transfer payments. The City of Kelowna has a Grant strategy in place to create this balance.

Some government transfers are relatively consistent from year to year however, the City occasionally receives one-time funding typically for infrastructure projects which will cause this ratio to fluctuate. The decrease in this ratio from 2019 to 2020 was the result of funding in 2019 related to the South East Kelowna Irrigation District (SEKID) project that had concluded by 2020.



Conclusion:

The City's strong overall financial health at the beginning of the year was challenged in some areas by the COVID-19 pandemic. The area to be cognizant of is the City's ratios in relation to Municipalities of similar size. It is important to note and consider when making decisions around this information that we are not comparing apples to apples in services and products however, it warrants investigation if the City shows significant differences.

The sustainability ratios show that the City has remained stable in meeting current financial obligations without increasing the debt or tax burden in a challenging year.

Decreasing revenues in 2020 challenged the City's flexibility position, but currently remain at acceptable levels. Should the trend of decreasing revenues continue, or if recovery is slow it may impact the City's ability to take on additional levels of debt, or respond to future infrastructure replacement demands. When making determinations on funding the City should take this into consideration along with the financial strategies that are in place.

The City of Kelowna's vulnerability regarding its dependence on sources of funding outside of its control is currently being managed through its Grant Strategy and has shown to be within an acceptable range.

The City of Kelowna's indicators show fluctuation in response to uniquely challenging times, but remain in a good position to continue to build a vibrant community.