City Manager's Report

Consolidated Update

Restructuring Plan

To Assure the Long-Term Financial Sustainability for the City of Saint John

20 November 2019

INTRODUCTION

The City of Saint John's current financial challenges are well documented and are a result of decades of decisions and economic considerations. Today, moving into 2020, the City's past is catching up with us and we are no longer able to provide the services that our citizens have come to expect or provide salary increases to our workforce in line with those to which they have become accustomed. In short, we can no longer afford the status quo.

Interim government funding ceases at the end of 2020 and this, combined with our ongoing financial struggles, will lead to a significant budgetary shortfall in 2021 and beyond. This shortfall could be as high as $10 million dollars per year in the first few years and could grow by approximately $1.5 - $2 million per year thereafter. Our costs historically grow at approximately 3% per year while our revenue growth traditionally averages 1% per year. Clearly, this is not sustainable.

Our current financial situation demands that we act now. Not only must we address our short-term yearly budgetary deficits (required by law) but we must solve the problem for the long term. Otherwise, each and every year we will be discussing and debating further cuts to services and/or to our workforce in order to make ends meet. This too is not sustainable.

One could argue that we can solve our challenges through growth. Although this is categorically true, we must be realistic. An optimistic Gross Domestic Product (GDP) growth rate in New Brunswick is forecasted by most to be around 1% per year for at least the next five years. Therefore, the City of Saint John would have to exceed provincial averages for growth in order to get close to addressing our annual cost increase of 3%. The City staff has embraced as part of their culture that "it is all about growth". This is true. But by being realistic on how much growth can be achieved, we immediately come to the conclusion that we not only must focus on growing our City but also on controlling costs.

Growth increases our property-tax base and we receive most of our revenue (approximately 80%) through that tax base. However, our revenues could also be increased through property tax reform, empowerment of the City by the Province to revenue generate, and through regional cost sharing of services provided by Saint John to our neighbours. These fundamental reforms are critical to our long-term financial health and the corresponding long-term financial health of the region and the province.

This City Manager's Report has three objectives: to summarize the key drivers within our current financial situation; to consolidate the entirety of Common Council's decisions on sustainability issues to show the overall restructuring plan; and to suggest what remains to be done.

Our restructuring plan must not be solely focused on addressing our anticipated shortfall in 2021 and 2022. Clearly, we need to balance our books but such a plan does nothing for our long-term financial health. Our plan must obviously consider our looming budgetary deficits

but it must also set us up for success in the out years. A balanced and comprehensive approach is warranted.

Background Material

This Report attempts to summarize the financial challenge and explain the plan to address it. For brevity, not every aspect is detailed within this document. There are several other products that are valuable references. All of this material is available on the City of Saint John website:

1. City of Saint John Roadmap to Smart Growth, 2017
2. City of Saint John Population Growth Framework, 2018
3. Building a Sustainable Future for Saint John, A 2018 Provincial Election White Paper, 2018
4. City of Saint John Fair Taxation Report, 2017
5. Testimony on Fair Taxation to Standing Committee, 2019
6. Municipal Property Tax Issues The City of Saint John (Kitchen & Slack), 2017
7. City of Saint John Backgrounder: The Path Forward, 2019
8. 8 Cities White Paper, Strong Cities, Strong Province, 2019
9. Sustaining Saint John – A Three Part Plan, 2019

THE FINANCIAL FACTS

Table 1 illustrates the sources of our budgetary revenue. Although it varies slightly year to year, two key deductions can be made. First, we are overly reliant on a singular source of revenue (property tax) and must diversify. Second, our current ability to generate our own revenue is limited and must improve.

	Budget (Including LNG)				
	2020	**2019**	**2018**	**2017**	**2016**
Property Tax	$ 127,906,924	$ 125,704,830	$ 123,443,042	$ 122,979,450	$ 120,182,422
Unconditional Grant	$ 16,131,081	$ 16,279,669	$ 15,659,510	$ 19,328,372	$ 19,923,206
Financial Assistance	$ 7,675,651	$ 7,117,402	$ 4,717,196	$ -	$ -
Own Sources	$ 14,427,459	$ 12,119,600	$ 12,112,787	$ 12,525,989	$ 11,436,556
Previous Year Surplus	$ -	$ 86,557	$ 1,338,515	$ 416,472	$ -
Total	**$ 166,141,115**	**$ 161,308,058**	**$ 157,271,050**	**$ 155,250,283**	**$ 151,542,184**

Table 1

Table 2 shows our growth rates for the past 5 years. The key deduction from this slide is that we must continue our efforts to increase the growth rate. As comparators, Moncton and Fredericton had growth rates of over 4% in 2019 and two of our neighbouring towns had growth rates around 3%. We must do better.

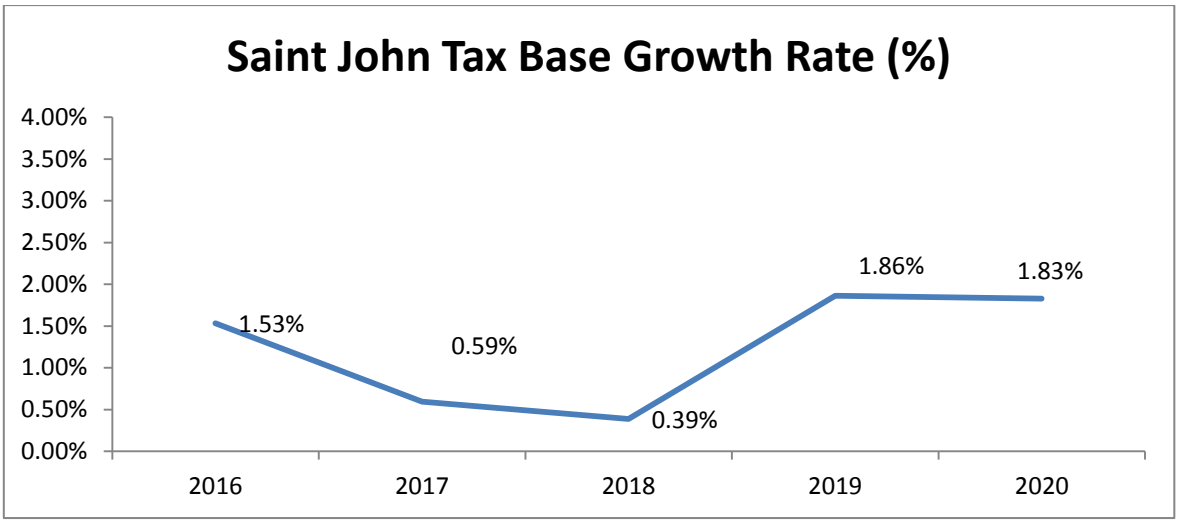


Table 2

Table 3 is illustrative to highlight the importance of growth. It presumes our 2019 operating budget as the base and status quo budgets moving forward. Using various growth rates, the forecasted operating deficit is shown. The key deduction is that time, money and effort spent to improve the City's growth rate would be extremely beneficial.

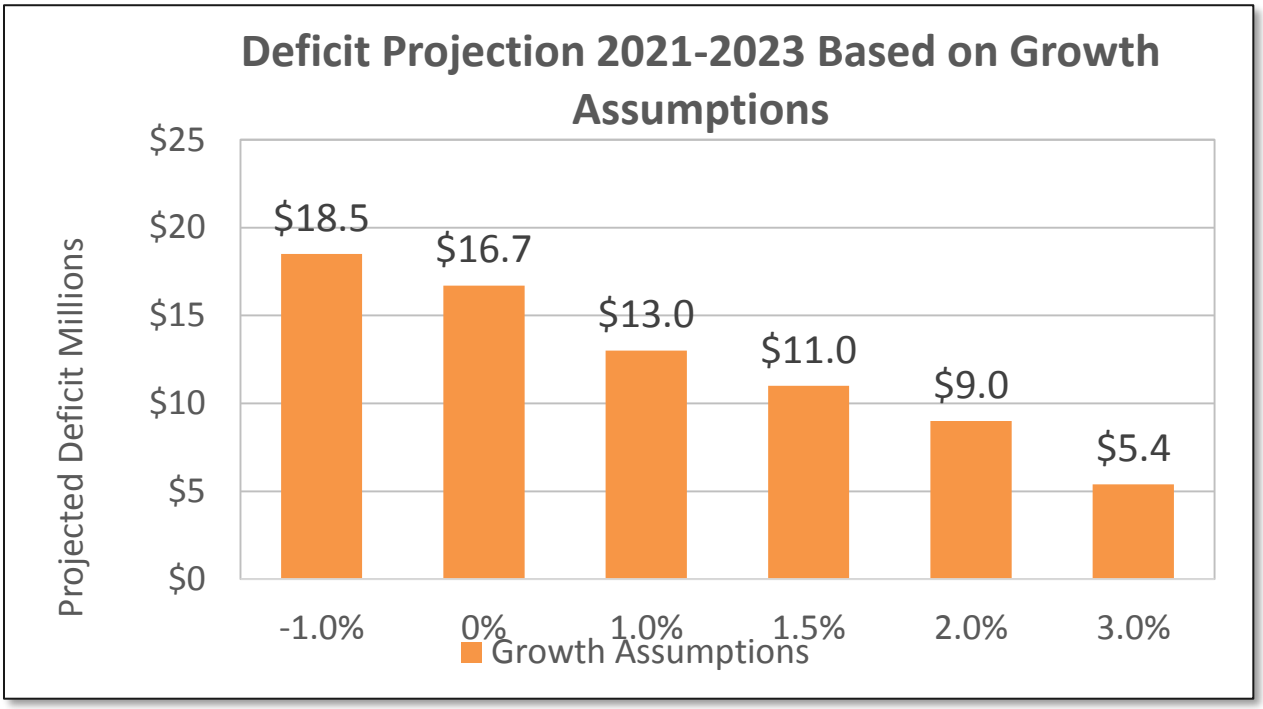
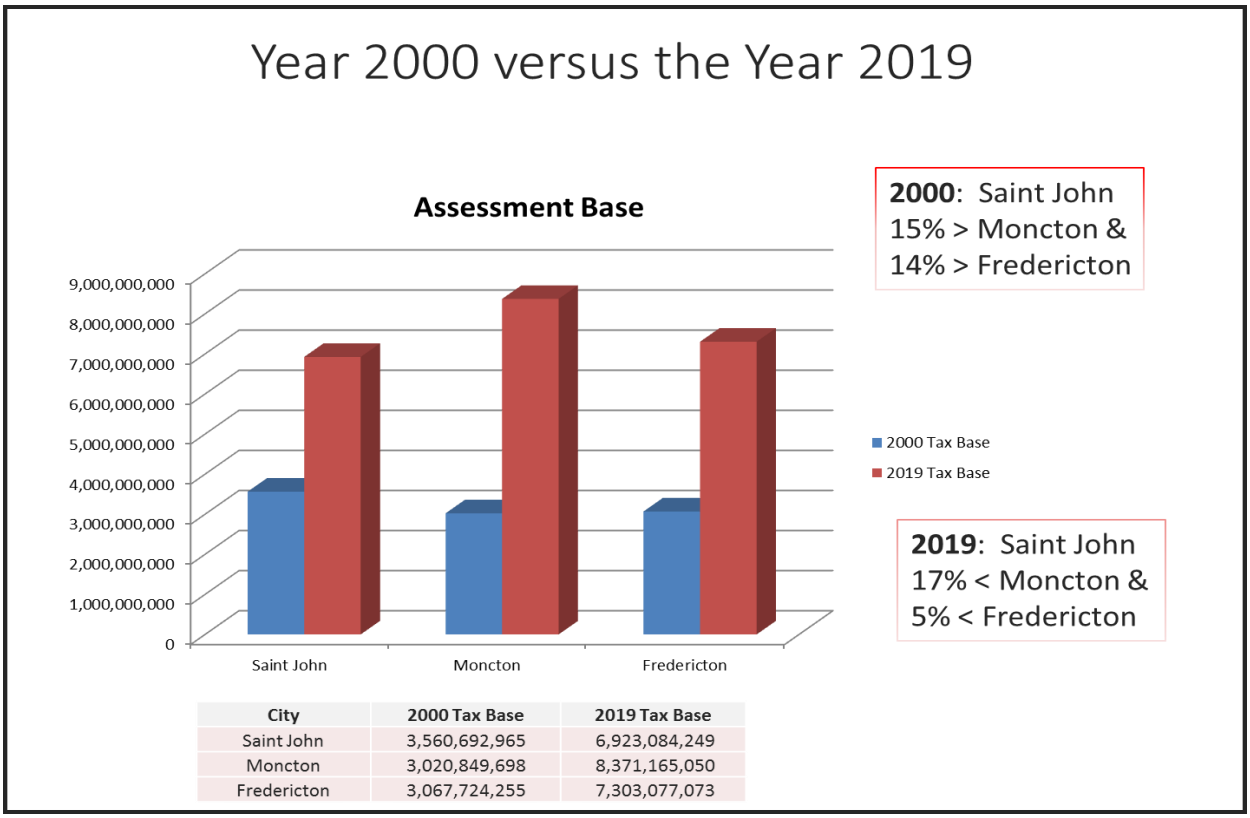


Table 3

The reality is that the City of Saint John has underperformed in growth for the past two decades. Table 4 shows our property tax base compared to that of Fredericton and Moncton. Leading in 2000, we now trail both other major cities in New Brunswick. This is not a contest. But it does demonstrate that we have failed in the past few decades to attract the growth necessary to prosper.



City	2000 Tax Base	2019 Tax Base
Saint John	3,560,692,965	6,923,084,249
Moncton	3,020,849,698	8,371,165,050
Fredericton	3,067,724,255	7,303,077,073

Table 4

As previously mentioned, growth has been increasing at approximately 1% per year. However, costs have been increasing at 3% per year. This is not sustainable and yet is the current reality.

Part of this increase is attributable to inflation as reflected through increases in the Consumer Price Index (CPI). Over the past 15 years, CPI has increased by 27.5% or an average of 1.8% per year. A more significant driver for our costs has been salary increases. Table 5 below shows the wage increases of all employee groups paid by the City. The wage increases are clearly higher than CPI and because our “people costs” consume approximately 57% of our total budget, wage increases have the greatest impact on our overall costs.

The impact of our wage increases has been described in many ways, some of which are included within the reference documents identified at the beginning of this Report. For the purposes of this document, I would simply highlight that if wage increases had been tied to CPI for the past 15 years, the City would have avoided approximately $100 million in costs. That said, wage increases above CPI are often appropriate. Therefore, as another measure,

if the City's recently adopted wage escalation policy had been in effect for the past 15 years, the City would have avoided approximately $57 million in costs.

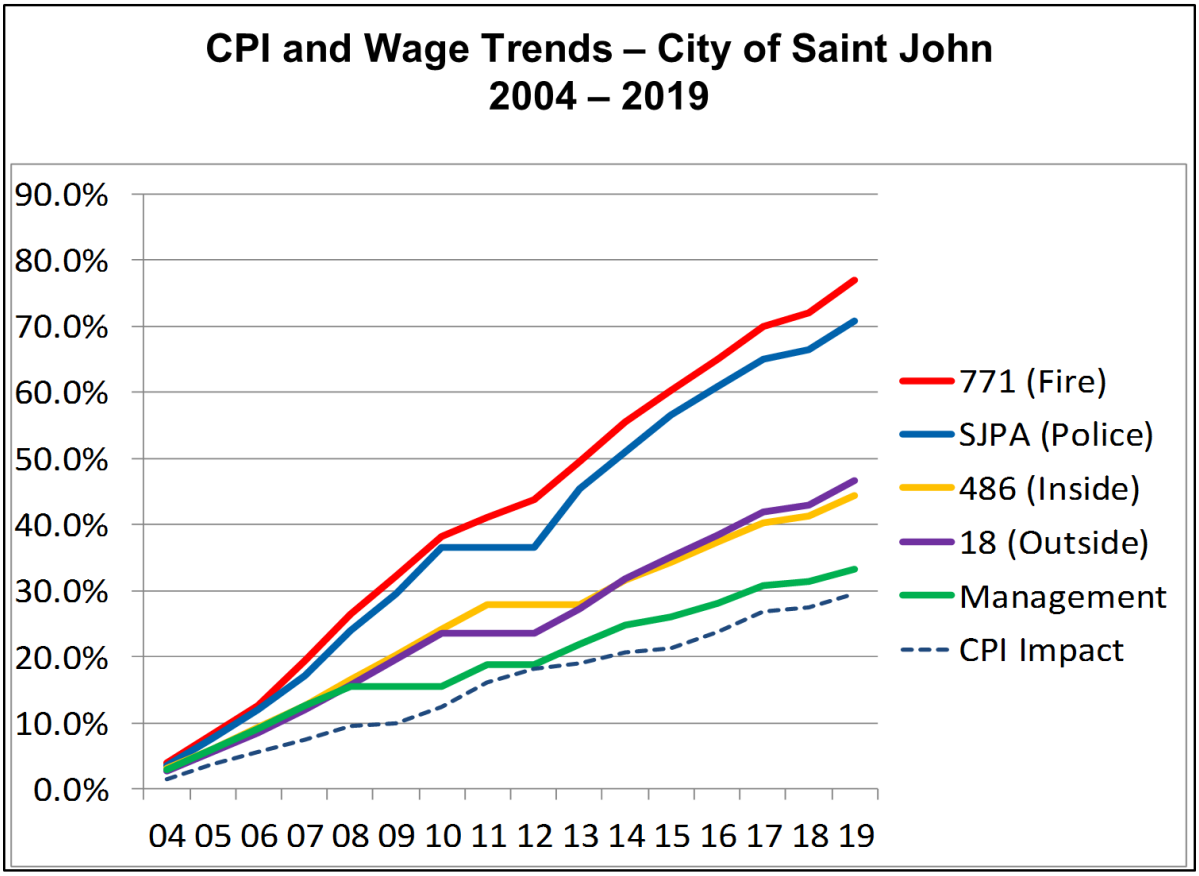


Table 5

The City has a Structural Deficit

A government budget deficit occurs when a government spends more than it receives in tax revenue, while a **structural deficit** is when a budget deficit persists for some time. **Structural deficits** will eventually pose a problem for any government and this is certainly the case now in Saint John.

Our structural deficit exists due to the reality that our costs are increasing at a rate faster than our revenues and have been for the past several decades.

The City's residential property tax rate, by decision of three successive Common Councils, has remained fixed for the past 11 years. Since the non-residential (commercial/industrial) rate is, by law, directly tied to the residential rate, it too has remained constant. Unlike provincial or federal governments, a municipality is not permitted (by legislation) to run a deficit and therefore our books must be balanced annually. With costs outpacing revenues and with a constant tax rate, balanced budgets over the past decade have been achieved through an overall approach of austerity, decreases to the size of the workforce, and reduction of services. Metaphorically, we have been "shaving the ice cube" or "taking

haircuts" to make ends meet. Having done so for many years, the reality is that this approach will no longer work for us since the reductions required are simply too large.

Table 6 below illustrates our overall challenge for long-term financial sustainability. Our structural deficit exists because revenue growth hovers around 1% and costs increase 3% annually. Therefore, a gap exists yearly to balance our budgets and the gap grows larger each and every year.

Clearly, we must improve our growth which will improve our revenue. But, unless we achieve consistent growth every year of at least 3%, the structural deficit persists and the gap between costs and revenues widens.

Right now, we have interim government funding that addresses the gap and allows us to balance our yearly budgets (shown in green on the graph below). This funding ceases 31 December 2020 and at that time, significant cost reductions and some (albeit limited) additional revenue streams must be implemented to close the gap (shown in red on graph below). The gap is projected to be an average of $10 million annually for 2021 and 2022.

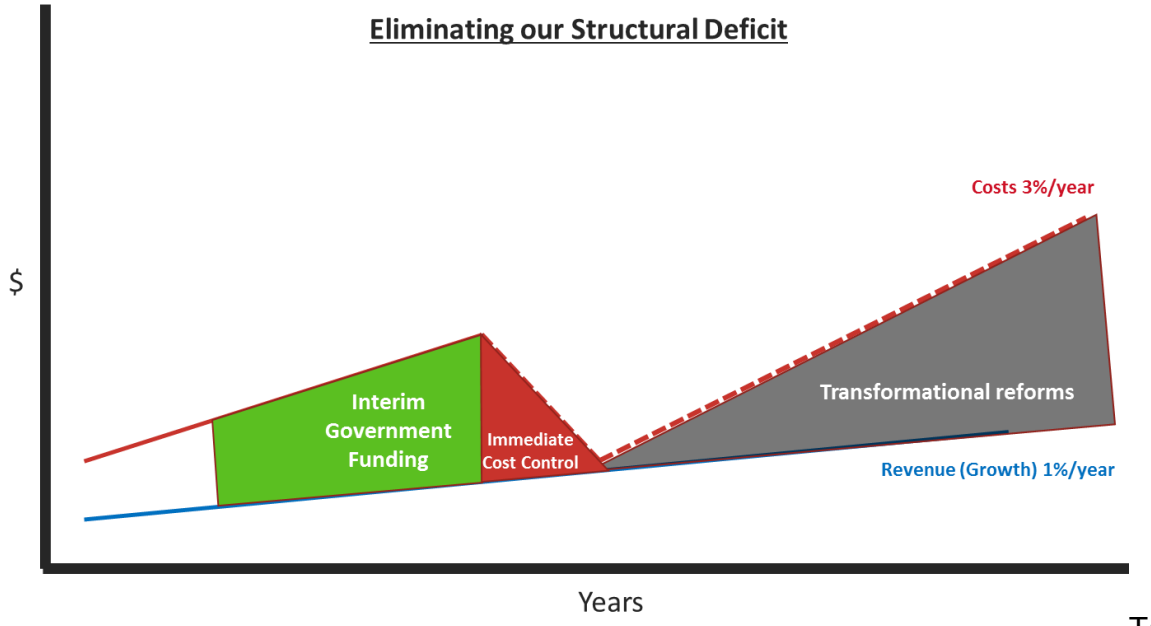


Table 6

Most importantly, cuts do **NOT** solve the structural deficit. At any point in time where we close the gap through cuts (and we intend to do so for 1 January 2021), the gap begins anew immediately thereafter. It is essential for long-term sustainability to solve the structural deficit through transformational reforms that permanently eliminate the variance between costs and revenue. These transformational reforms will be discussed briefly later in this document and are also discussed in the background material referenced earlier. They include: comprehensive property tax reform, binding arbitration reform, wage escalation control, empowerment of cities to generate their own revenues, removal of restrictive clauses in collective agreements, regionalization of services and regional cost sharing.

Without successful transformational reforms, the City will have no choice but to continually cut services and its workforce, which will impede growth, which will further exacerbate the gap, which will lead to exponentially more drastic cuts and negative growth and which will eventually lead to the City being a shadow of its former self.

Other Financial Challenges

In addition to the structural deficit, The City has two other key financial considerations that affect our long-term financial health.

First, the City's debt load is high. At its peak in 2018, the debt was approximately $240 million. Currently, the debt is at approximately $230 million. Servicing the debt imposes budget pressures of approximately $17 million annually, which equates to 11% of our total budget. Other than limiting flexibility since borrowing more is highly problematic, imagine if our annual debt payments were significantly less. If our debt load was reduced by 60%, we would currently not have a gap between costs and revenues.

The other issue is the age of our infrastructure. Based on our most recent asset assessments, the City has $430 million of infrastructure that is at or beyond its useable life. Not only does this put tremendous pressure on our capital budgets, the state of our infrastructure leads to higher maintenance and operating costs which has a direct impact on our ability to balance our annual budgets

THE RESTRUCTURING PLAN

The scope and magnitude of our financial challenges require a comprehensive approach that includes short-term fixes and long-term initiatives that fully address the structural deficit, our debt load and our asset management. In short, we must restructure through a deliberate plan.

The restructure plan that has been developed has three distinct parts. Since all parts must occur simultaneously, the term "three-pronged" has been used to emphasize that we must work on multiple fronts concurrently.

Overall, the restructure plan can be summarized as follows:

- Prong 1: Efficiency and effectiveness reviews and development of strategic policy.
- Prong 2: Short-term sustainable initiatives to address the entirety of the deficit anticipated in 2021 and 2022.
- Prong 3: Transformational reforms implemented for 2023 and beyond.

Prong 1 – Reviews and Policy Development

When looking at restructure, individual continuous improvement initiatives only take an organization so far. But by embracing a continuous improvement culture, organizations are driven to occasionally fundamentally re-visit how things are done and who does them. The City of Saint John will complete comprehensive reviews on the following and reap the benefits of these reviews in time for Budget 2021:

- Review of all agencies, boards and commissions to find efficiencies and to improve effectiveness.
- Review of our economic development framework to achieve better alignment and synergy amongst the various stakeholders.
- Review of the organizational structure of City Hall to reduce its size and yet maintain its effectiveness.
- Review of all infrastructure to enhance asset management.
- Complete an operational audit of the City's organization and its delivery of services to identify viable cost savings.

Details on these reviews are available from the background material referenced at the beginning of this document and in a variety of staff reports presented to Common Council.

The reviews may identify policies and procedures that need to be developed and implemented. In addition, there is an entire suite of financial policies that are being developed to help impose a high level of discipline in future decision-making associated with tax-payer dollars. All will be fully developed and implemented by the end of the first quarter 2020:

- Wage Escalation Policy – already approved by Common Council, this policy aims to ensure that future salary increases are affordable.

- Debt Management Policy – already approved by Common Council, this policy aims to discipline future spending where borrowing will be required so as to control our overall debt. It also aims to lower our debt over time.
- Asset Management Plan – aims to firstly improve our understanding the state of our infrastructure and then to prioritize maintenance, capital repair and capital replacement.
- Capital Budget Policy – already approved by Common Council, this policy aims to ensure capital budget decisions are prioritized based on evidenced based information. Operating expenses and third party assets shall not be included.
- Operating Budget Policy – already approved by Common Council, this policy mitigates the risk of future structural deficits by forbidding the funding of operating expenses with one time revenues.
- Reserve Policy – already approved by Common Council, this policy supports long term funding strategies by promoting saving today to spend tomorrow rather than continuing the City's heavy reliance on debt. The policy also allow the City to set funds aside for unexpected future events, and therefore reducing the risk of future deficits.
- Investment Policy – already approved by Common Council, this policy ensures the City maximizes return on investment while minimizing risk.
- Long-Term Financial Plan – aims to provide a roadmap with anticipated outcomes for financial decision making. Plan will look out ten years.

Prong 2 – Short-Term Sustainability Initiatives

With the lapse of current interim government funding at the end of 2020 and the reality that most transformational reforms will not be completed and providing tangible results before 2023, there is a need to implement short-term sustainability initiatives that will address the entirety of the deficit for 2021 and 2022. The details on the various initiatives and the overall options are the subject of ongoing analysis and discussion with Common Council.

Although Common Council may choose to implement some initiatives at the beginning of 2020, we envision the bulk being implemented sometime during the year with all complete (fully implemented) <u>before</u> 1 January 2021.

To achieve this, Common Council will need to make all decisions on the short-term initiatives no later than the end of March 2020. This will allow the staff sufficient time to implement the decisions before 1 January 2021. Put another way, all initiatives to address the budget shortfall will occur at some point during 2020.

There are over 60 various ideas currently being explored. Based on Common Council decisions and guidance to this point, these ideas can be grouped under four main themes:

- 50 % of the entirety of the deficit will be addressed through workforce adjustments and changes to personnel policies.

- Where possible, the City will divest its infrastructure to avoid large operating deficits.
- Revenue streams, within the limits of current legislation, will be enhanced; including non-resident user fees.
- New and/or innovative approaches to the delivery of services will be pursued based on best practises in other communities and fundamental reviews.

At this time, the forecasted deficit is $9 million for 2021 and $11 million for 2022. Since these forecasts are still subject to change, prudence demands that we plan reductions based on the average deficit over the two-year period, which is $10 million per year.

Prong 3 – Transformational Reforms

As mentioned previously, addressing our short-term financial deficit in 2021 and 2022 does not, in and of itself, assure long-term financial sustainability for the City. The internal reviews and the financial policies previously described will help but transformational reforms are required. Without them, the vicious cycle of cuts leading to more cuts and leading to unacceptable growth will continue.

The following key transformational reforms are required:

1. Comprehensive property tax reform. The Province's current property tax system dates back to the 1960s and must be reformed. There are questions on whether industry is paying their fair share. But there are also questions on tax revenue distribution, flexibility in setting differential rates, tax exemptions, and assessment practises that must be addressed. The Cities of New Brunswick Association has joined us in our assertion that the system of the 1960s no longer works in 2020 and must change. In "Sustaining Saint John – A Three Part Plan", the Province has agreed to conduct a comprehensive property tax review and to have all changes in place by the end of 2022.

2. Regional cost sharing. There are over 18,000 work commuters who enter the city daily, placing wear and tear on our infrastructure and requiring some of our services. Also, over 30% of all users of our subsidized recreational facilities are non-residents and therefore pay no taxes towards the subsidizations from which they benefit. In past years, Saint John could afford to cover these costs but we are no longer able to do so and some method of regional cost sharing must be put in place.

3. Regionalisation of services. The entire region has only approximately 130,000 people yet we have at least three of everything when it comes to providing services (fire, police, EMO, waste management, road works, etc). There are efficiencies to be had through regionalisation of these services.

4. Wage escalation control. All of our workgroups have seen pay raises greater than CPI over the past 15 years. This has occurred at a time when only approximately 40% of 'New Brunswickers' receive any pay raise whatsoever and within that group, the average pay raise is 1% (which is well below annual CPI). Common Council has approved a wage escalation policy. This policy will only be transformational once it is embraced by all and the City has the discipline and tools available to adhere to this vital policy.

5. Binding arbitration reform. The New Brunswick Industrial Relations Act prevents firefighters and police officers from going on strike. In exchange and to ensure that they are well compensated for their work, the Act entitles them to proceed to binding arbitration if freely negotiated collective bargaining does not provide what they judge to be acceptable contracts. The unintended consequence of the Act has been approximately 70% cumulative pay raise for police and fire over a 15 year period. During that same 15-year period, CPI has increased by only 27.5%. The eight cities of New Brunswick have all passed an identical motion proposing an amendment to the Industrial Relations Act that would still ensure that the original legislative intent is achieved. There is no desire to limit free and open bargaining nor is there a desire to remove the right to binding arbitration. The proposal does not intend to impose limits on the binding arbitrator's ability to award costs rather, it simply ensures that arbitrator decisions are completed in an efficient manner, are more accountable and transparent, and importantly tied to meaningful assessments of a municipality's fiscal health.

6. Empowerment of cities to generate own revenues. Another limitation to our success is that we, broadly speaking, can only generate increased revenues for enhanced service delivery through raising of municipal taxes. Any opportunity to generate additional revenue through areas like renewable energy generation or professional service delivery is currently not allowed – meaning that city taxpayers are forced to pay more for any introduction of enhanced or updated services or find corresponding offsets elsewhere. Municipalities, particularly our eight cities of New Brunswick, are professional service organizations with the knowledge and ability to develop economic generation ideas to improve services without raising taxes. Saint John is not looking to be able to compete with the private sector, but rather explore new revenue-stream opportunities that would reduce the cycle of our citizens always having to pay more. Many cities in Canada are now being provided "Charters" from their provincial authorities. Ideas such as this must be pursued in this Province.

This list of transformational reforms is not intended to be exhaustive. There are other important smaller reforms that would help, such as the removal of limiting language in collective agreements and better alignment of provincial and federal capital expenditures within the region. But the six reforms briefly described above are necessary to complete the transformation of the City's financial situation, leading to long-term sustainability.

NEXT STEPS – WHAT IS LEFT TO BE DONE

First and foremost, the City must put in place the necessary initiatives to address the entirety of the deficit in 2021 and 2022. Details for this are ongoing and will be deliberated by Common Council, with all decisions made by March 2020. This, in turn, will provide the necessary time for the transformational reforms to take hold.

The internal reviews and completion of the financial policies are fundamental to our long-term success and must be finalised in early 2020.

The City must also focus some attention on the re-assessment that it will undertake in March 2020 to determine if ***"Sustaining Saint John – A Three Part Plan***" is actually working and leading to the expected results. It must also work closely with the province for the provincial re-assessment that is also mandated to occur in March 2020 and then hold the province accountable for taking additional actions as required and as committed to in ***"Sustaining Saint John – A Three Part Plan".***

Finally and arguably most importantly, Common Council and all City staff must continue to place priority effort on the transformational reforms. These reforms, by their very definition, are the keys to our long-term financial sustainability. Moreover, when the City achieves the financial stability that it needs, the attractiveness of the city to new residents and businesses and the re-invigorated messaging surrounding our community will have dramatic positive impacts on growth.

Common Council's emphasis on growth and prosperity, while also being fiscally responsible, has resulted in the initiatives described in this report and in the overall restructuring plan. More difficult decisions lie ahead, as does a tremendous amount of work within this plan, but the potential for long-term financial health merits the effort required.