

PROPOSED ADJUSTMENTS TO THE 2016 BUDGET

EXECUTIVE SUMMARY

The current state of the economy provides two opportunities: 1) to refocus the capital budget toward economic stability and stimulus, and 2) to recast the capital budget toward a more realistic annual estimate that takes into account The City's capacity and constraints. This report requests Council's approval of the Capital Infrastructure Investment Strategy (Investment Strategy), including potential funding as necessary, the adjustments to, and adoption of, the 2016 capital budget, and the carry-forward of operating budgets. The Capital Infrastructure Investment Strategy recasts the capital budget's cash flows, reprioritizes projects to reflect the corporate view of the current circumstances and removes constraints to increase the capital budget spend rate all within the current approved tax rates. The adjustments to the budget represent expediting a few "shovel ready" projects that have been approved for future years.

ADMINISTRATION RECOMMENDATION(S)

That Council:

1. Approve the Investment Strategy review process as shown in Attachment 1 and direct that Administration return by Q2 2016 with a recommended recast capital budget;
2. Approve Administration's proposed adjustments to the 2016 capital budget, shown in Attachment 2, and adopt the 2016 capital budget of \$2.34 billion as adjusted, shown in Attachment 3;
3. Receive for information Attachments 4 through 9; and
4. Approve the carry forward of operating budgets from 2015 to 2016 as shown in Attachment 10.

PREVIOUS COUNCIL DIRECTION / POLICY

On 2006 July 12, Council approved FCS2006-30 Project Management which established the Corporate Project Management Office, with funding established as a maximum 0.5% charge against all capital budgets.

On 2014 December 1, Council approved the 2015-2018 Action Plan, as amended (C2014-0863), including a 2016 capital budget of \$1.6 billion.

On 2015 February 10, Council was presented with the Economic Resilience Program that provided service delivery adjustments in response to the emerging economic downturn. The seven strategies of the Economic Resilience Program emphasize the need for The City to continue to deliver services to Calgarians in a responsible fashion, and to stay financially prudent in the midst of changing economic conditions. The Economic Resilience Program proposed that in the short term, The City's strategy is to retain productive people, businesses, incomes, jobs and investment projects, while preparing for economic recovery. The City would also continue to invest in infrastructure, create employment and prepare for future growth and resiliency. An update on this program was presented to Council on 2015 June 22 (C2015-0550 Resilience and Economy).

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On 2015 April 27, Council approved PFC2015-0347 (Capital and Operating Budget Revisions Report for the Period 2014 JULY 01 TO DECEMBER 31). The realignments of capital cash flows increased the 2016 capital budget to \$1.9 billion from \$1.6 billion.

On 2015 September 28, Council approved PFC2015-0697 (Capital and Operating Budget Revisions Report for the Period 2015 JANUARY 01 TO JUNE 30). The realignments of capital cash flows increased the 2016 capital budget to \$2.3 billion. Council also approved and adopted C2015-0696 the 2016 Resilience Operating Budget that indicated the reintroduction of the 2016 Capital Budget adjustments and the 2016 operating budget carry forwards to the 2015 November 25 meeting of Council. Council also received for information a presentation on Capital Investment Strategies.

BACKGROUND

Section 245 of the Municipal Government Act requires each municipality to adopt a capital budget for the calendar year. The City's annual business plan and budget Adjustments process provides the opportunity for the organization to adjust its multi-year business plans and budgets in response to economic fluctuations. Oil price declines from the levels assumed in Action Plan have created significant uncertainty for The City in the current economy. Effective capital spending can provide some stability to Calgary's economy.

The presentation to Council on 2015 September 28 highlighted the importance of The City's capital investment, particularly in terms of job creation and other economic benefits, and outlined Administration's approach to capital investment. The investment strategy outlined in this report builds upon the information provided to Council in that presentation.

INVESTIGATION: ALTERNATIVES AND ANALYSIS

Since the operating budget was approved in September, Administration has been working on positioning the capital budget as an immediate and longer term infrastructure investment strategy that aligns with provincial and federal infrastructure priorities, and maintains our corporate financial future. This report addresses what has become our organization's most pressing issue – capital infrastructure investment.

The City's total capital infrastructure budget for 2015-2019 is over \$8 billion, not including the Green Line, or potential capital matching programs from the two senior levels of government through infrastructure and 'shovel ready' funding initiatives. There are several principles that support this Investment Strategy:

- Principle One: the strategy must be based on existing capital budgets, with no impact on the tax rate established within the Action Plan.
- Principle Two: the strategy must be focused on necessities, the infrastructure that meets immediate needs, and builds future capacity for growth and prosperity.
- Principle Three: the strategy must support our local economy during this downturn, and help to keep people working within our city.
- Principle Four: the strategy must position Calgary for recovery to 'business as usual' when the national and provincial economies rebound, and oil prices stabilize.

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- Principle Five: the strategy must have capacity to invest in 'higher risk' projects to enable a more diversified local economy.

The strategic focus on capital infrastructure investment will require some organizational realignment and continued advancement of our cultural shift. As learned through Flood Recovery Operations Centre and Build Calgary, implementation of strategic priorities takes collaborative and committed effort by civic departments. These initiatives showcased the need to build cross functional organizational structures and teams that maintain a singular focus throughout an initiative's 'life span'. The intention is to organize ourselves accordingly to implement an aggressive infrastructure program. As experienced through similar initiatives, our organization may not have the existing capacity to execute corporate strategy; such capacity needs to be optimized and acquired to be successful. Meeting an advanced and aggressive infrastructure investment program will take considerable organizational collaboration and coordination. All aspects of the 'investment process', from procurement, to project management, to risk oversight, to engagement, and to all other associated activities will need to be streamlined. The 'end-to-end' process will need to be as efficient as possible.

The current \$2.3 billion capital budget or 2016 comprises:

- \$1.4 billion for growth projects;
- \$522 million for maintenance projects;
- \$115 million for service increase projects; and
- \$254 million for upgrade projects

In terms of capital infrastructure investment, the above may be categorized as follows:

- \$925 million for Transportation infrastructure;
- \$408 million for Cultural, Parks and Recreation infrastructure;
- \$448 million for Water infrastructure;
- \$127 million for Waste & Recycling infrastructure;
- \$98 million for emergency services (including Police) infrastructure; and
- \$285 million for corporate infrastructure.

Administration has also been considering projects totalling \$47.5 million in the 2017 – 2019 capital budgets that could realistically be expedited to 2016 and provide modest additional economic stimulus (Attachment 2).

Over the years, The City's capital spend rate has been approximately 50% to 60% of the final capital budget. In the past, The City has not spent more than \$1.5 billion in capital in a single year. Based on historical experience and current information, it is expected that between \$700 million and \$900 million will be carried forward from the 2015 capital budget into 2016, potentially bringing the total 2016 capital budget to just over \$3 billion. Administration acknowledges that actual spending will be closer to \$1.5 billion in 2016.

As part of Build Calgary, Administration has been engaging the private sector construction and financing industries, including developers, to fully understand the market's capacity and issues to deliver City infrastructure investment. Administration has also been engaging citizens on the

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impact of the economy and what The City can do to sustain the economy. Preliminary observations from this engagement (Attachment 8) have indicated that citizens have considerable concern over the economy and see a role for The City to provide market stability through capital infrastructure investment. There also appears to be support for reviewing and reprioritizing spending priorities. This is consistent with the investment priorities articulated in the provincial budget and in the federal election campaign platform presented by the successful Liberal Party of Canada.

Through the Accelerating Capital for Economic Resilience (ACER) project, the delivery constraints and cash flow projections have been assessed to determine expenditure improvement (i.e. bring up the spend rate) to provide Council with a more realistic budget. A more realistic capital budget supports Council's priority of a Well Run City. Attachment 7 contains a summary of the ACER project findings to date. An increase in the charge against capital budgets from up to 0.5% to a maximum of 1.5% is required in order to fund ACER improvement initiatives. Administration will refine the actual charge once the resources required to remove the delivery constraints are fully identified.

The Provincial budget released on 2015 October 27 contained some potential increases in capital funding for The City. A total of \$330 million over three years was identified for transit, beginning with \$100 million in the Province's 2016-17 fiscal year. There was also an additional \$4.4 billion in funding for new capital projects and programs, beginning with \$148 million this year and \$834 million in 2016-17. No details around this funding increase were released in terms of eligible infrastructure or funding allocations. Based on past MSI allocations, Administration estimates that The City could receive approximately \$100 million of the transit funding (potentially \$30 million in 2016) and approximately \$1.3 billion of the \$4.4 billion capital funding; however until further details are released, these amounts are speculative. However, with \$1.5 billion in Federal funding for GreenLine already announced, Administration is continuing to pursue matching funding from the Province while determining an appropriate funding mechanism for The City's share. Administration is also maintaining a list of unfunded projects that may be eligible for this funding in order to quickly proceed as details are announced and funding is made available.

Both the currently approved 2016-2019 capital budgets and the proposed advancements are fully funded under the current approved tax rates. The proposed capital budget does not require any further tax rate increase from those established in Action Plan.

The budgets prepared in Action Plan were based on assumptions of higher oil prices. However, since the preparation of Action Plan, oil prices have dropped considerably and are remaining low longer than anticipated. This has created a much slower economic environment for Calgary, which in turn provides a twofold opportunity for capital infrastructure investment that:

1. takes advantage of softer construction to deliver more investment; and
2. provides stability and stimulus to the economy, including job creation.

To date, the softer pricing is focused on civic construction (e.g. roads, earthworks) where prices are showing decreases of 10% from Fall 2014. Prices on building construction are not currently showing decreases, due mainly to the depreciation of the exchange rate.

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Results from a recent Ipsos poll presented to Council on 2015 September 28 showed significant support in Alberta for governments to invest in infrastructure to keep the economy going (88%) and benefit from lower costs (83%) during an economic downturn. The same poll also showed recognition of the economic role of municipal governments during economic downturns.

The City has taken that role through the Economic Resilience Program, where capital infrastructure investment is a key component, directly contributing to five strategies/Key Result Areas (KRA) identified in C2015-0550, where The City will:

- continue to provide service delivery to Calgarians (KRA 1)
- invest in infrastructure that creates employment and prepares for future growth (KRA 4)
- identify and respond to what is required to retain productive people, businesses, incomes, jobs and investment projects (KRA 5)
- contribute to the creation of a more resilient local economy (KRA 6)
- contribute to the creation of a vibrant and prosperous downtown Calgary (KRA 7)

Attachment 1: Proposed Capital Infrastructure Investment Strategy

The capital budget has been reviewed and includes project advancements that provide further economic stimulus that take advantage of softer pricing. Although the addition of these projects will slightly increase the 2016 capital budget, Administration acknowledges that the current capital budget as defined will not be fully spent. In conjunction with the ACER project, Administration is committed to building a strategy to restructure and increase The City's capacity to spend capital funding on priority projects. This will involve:

- Critically examining and recasting cash flows: revising the expected cash flows to be more reflective of the expected expenditure pattern;
- Determining the priority projects: reviewing the prioritization of capital projects and develop the corporate priority list;
- Aligning the capital investment with Federal and Provincial government initiatives: reviewing Federal and Provincial governments' announcements to identify incremental funding initiatives; working with these governments to identify priorities and processes for capital infrastructure investment; and aligning The City's capital investment priorities accordingly;
- Reviewing funding sources and switch accordingly: consider the funding sources and allocate on the basis of the most restricted sources first, in an attempt to free unrestricted funding;
- Review allocation of funding: reviewing the current allocation of funding and redistribute to best meet the corporate priority list;
- Standardizing processes: standardizing cash flow estimation, procurement and permit application processes in order to gain efficiencies and removing key bottle necks;
- Funding additional resources: fund capital project acceleration initiatives through an increase of the existing corporate project management charge against capital budgets from up to 0.5% to a maximum of 1.5%; and
- Examining ways of involving the private sector to a greater extent: continuing discussion with the private sector to determine the degree to which their participation can be increased in order to speed processes and delivery of infrastructure.

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- Identifying the operating costs of new capital projects: The operating costs of new capital projects must be identified and any associated incremental Operating Budget funding relating to those projects be approved along with the Capital funding associated with those projects.

This will be a coordinated effort between Growth Management, Human Resources (human capital plan), and Finance & Supply (budget and procurement strategies). The human capital plan (Attachment 9) will be an important component. This plan will help resource investment strategy delivery by addressing capacity issues and will include:

- Exploring a corporate approach to vacancy management;
- Identifying critical positions and skills;
- Analyzing current human capital, e.g. retirement risk, labour relations strategy;
- Resourcing: hire, contract services, contract out;
- Taking a knowledge transfer approach;
- Gaining leadership support and clarity of purpose; and
- Reviewing business processes.

To ensure Administration is aware of the external capacity to deliver investment, continued discussions with the private sector will be necessary. As well, evaluation of The City's internal structures and processes is necessary to allow for greater efficiency and effectiveness in infrastructure prioritization and investment.

The Capital Infrastructure Investment Strategy, and in particular the reprioritization and allocation of funding, will factor in all available funding not currently allocated or allocated only for a defined period of time. This will span both tax-supported and self-supported services. To remove some of the constraints around capital investment, the Investment Strategy will place further pressure on the operating budget, as many of the constraints are related to staffing.

Further details of the Investment Strategy are shown in Attachment 1. The outcome will be increased flexibility in spending approved capital budgets and an aligned capital budget that reflects expected cash flows, resulting in "turning the curve" of The City's spend rate (Attachment 6). Any revisions to the capital budget will be presented to Council in the first half of 2016 during Budget Finalization.

Attachment 2: Proposed Capital Budget Requests for Advancements

Adjustments to the capital budget contained in Attachment 2 are in the form of advancements of previously approved shovel ready projects into 2016 from 2017, 2018 and 2019. No new capital projects are included in these adjustments. These advancements total \$47.5 million.

Given that each one million dollars in capital spending is estimated to create over eight person year jobs, advancement of these projects will provide economic stimulus including the creation of approximately 400 person year jobs.

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Attachment 3: Proposed Adjusted 2015-2019 Capital Budget Summary, Attachment 4: Proposed Adjusted 2016 Capital Budget Summary and Attachment 5: Project Listings - Approved 2015-2019 Capital Budget totalled by Department Including Proposed Advancements

The 2015-2019 capital budgets including the 2016 capital budgets for adoption are shown in Attachment 3. Summary charts of the proposed adjusted 2016 capital budgets are shown in Attachment 4 and include the advancement projects in Attachment 2. Any incremental impacts in the operating costs of capital from these additional projects will be identified through the Mid-cycle review beginning in 2016. Attachment 5 shows the individual projects that have previously been approved by Council as well as the advancement projects in Attachment 2.

Attachment 6: Increase The City's Capital Spend Rate

As noted above, The City's capital spend rate has typically been between 50 percent and 60 percent, due largely to budgets that are heavily front loaded. In the absence of the Investment Strategy, or any other action from Administration, it is expected that the same pattern will continue, with constant deferrals and carry forwards into latter years, reducing transparency around the capital budget. A key outcome of the strategy, as illustrated in Attachment 6, is a more realistic capital budget that increases transparency and supports Council's priority of a well run City.

Attachment 7: Accelerating Capital for Economic Resilience (ACER) Summary

Attachment 7 summarizes the ACER project in terms of results to date, some short and long term opportunities, and the next steps. This attachment also summarizes the need to increase the maximum corporate project management charge from up to 0.5% to 1.5%. This funding will only be used as required and appropriate controls will be established.

Attachment 8: Research with citizens on Calgary's economy

Attachment 8 summarizes the initial observations from research with citizens related to:

- The current impact of the economy on individuals/families and their quality of life;
- Citizens' expectations of The City's role given the current economic environment; and
- Citizens' perceptions on what The City can do to help stimulate the economy.

Attachment 9: Human Capital Plan

Attachment 9 provides more detail regarding the Human capital Plan that will help create capacity to deliver capital projects.

Attachment 10: Carry forward of operating budgets from 2015 to 2016 for Council Approval

Council policy CFO004 (Multi-Year Business Planning and Budgeting Policy for The City of Calgary) permits the carrying forward of operating funds from one year to another within a budget cycle. Attachment 10 outlines Administration's proposed carry forwards of unspent 2015 operating budgets from 2015 to 2016, amounting to \$6.1 million.

Stakeholder Engagement, Research and Communication

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Through Build Calgary, Administration engaged with the private sector construction industry, including developers and construction associations, as well as the financial sector regarding The City's approach to capital investment.

This year The City has conducted citizen research related to Calgary's economy to understand:

- The current impact of the economy on individuals/families and their quality of life;
- Citizens' expectations of The City's role given the current economic environment; and
- Citizens' perceptions on what The City can do to help stimulate the economy.

The City partnered with IPSOS to conduct focus groups in each of Calgary's quadrants and fielded a telephone survey with 500 Calgarians to ensure we heard from a broad segment of Calgary's population. The complete research findings will be presented to Council. The early observations from this research are summarized in Attachment 8.

Following Council deliberations, the approved adjustments will be communicated to the public.

Strategic Alignment

The Adjustments process is an important aspect of multi-year business planning and budgeting, and is designed to maintain the direction and priorities established in the approved 2015 – 2018 business plans and budgets. The ability to adapt to the changing economic conditions is a critical aspect of the process. The Adjustments process allows Administration to adapt to changes in the external environment and propose adjustments that allow long term objectives to be met and support Council's priorities of a Well Run City.

Social, Environmental, Economic (External)

The adoption of the capital budget in Attachment 3 will help The City to continue to respond to changes in the economy while maintaining a focus on long-term goals and priorities. The approved capital budget brought forward by Administration represents the continued achievement of social, environmental and economic goals (i.e. in line with The Triple Bottom Line Policy) as outlined in the 2015-2018 Business Plans and Budgets while maintaining some economic stability.

Financial Capacity

Current and Future Operating Budget:

There are no net operating budget impacts identified in this report, beyond the impact on 2016 budgets resulting from the carry forwards identified in Attachment 10. The \$6.1 million represents approved one-time costs that are being carried forward into 2016.

Operating Costs of Capital

Action Plan identified the operating costs of capital related to the capital projects included in the 2015-2019 capital budgets. These costs were funded within the approved operating budgets. Any impact to these costs in 2016 from advancing the projects in Attachment 2 is anticipated to be negligible and will be managed within the adopted 2016 operating budget. Any incremental impacts in the operating costs of capital in 2017 and beyond from the additional projects being advanced, as well as the operating requirements to support the investment strategy, will be identified through the mid-cycle review in 2016. Any operating impacts from new projects

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resulting from increases in Federal or Provincial grants (e.g. Green Line) will be identified through the mid cycle review or in future budget cycles as appropriate.

Current and Future Capital Budget:

The budget recommended for adoption includes \$2.3 billion in funding that has already been approved by Council. Administration acknowledges that adoption of this budget will see further deferrals and carry forwards into 2017 and potentially beyond once cash flows are better determined in 2016.

Risk Assessment

The current low spend rate of capital funds is not optimal and presents a risk to The City's credibility. Approval of the proposed Capital Infrastructure Investment Strategy will allow The City to take a comprehensive approach to reviewing capital projects while proceeding with planned investment. The City must continue to stay flexible and be able to adjust its plans and budgets to manage its resources and support economic activity during this downturn.

Reducing capital investment at this point in the economic cycle would risk increasing the impact of the economic downturn rather than mitigating it.

REASON(S) FOR RECOMMENDATION(S):

To ensure that The City continues to support the longer term direction and priorities as approved by Council in the 2015-2018 Business Plans and Budgets, the approved capital budget allows The City to respond and adapt to emerging issues and changing circumstances, in particular, the current economic slowdown. The proposed Capital Infrastructure Investment Strategy review will better align the budget with the anticipated spending, factoring in and, where possible removing, the identified constraints to capital spending.

ATTACHMENT(S)

1. Proposed Capital Infrastructure Investment Strategy
2. Proposed Capital Budget Requests for Advancements
3. Proposed Adjusted 2015-2019 Capital Budget Summary
4. Proposed Adjusted 2016 Capital Budget Summary
5. Project Listings - Approved 2015-2019 Capital Budget totalled by Department Including Proposed Advancements
6. Increase The City's Capital Spend Rate
7. Accelerating Capital for Economic Resilience (ACER) Summary
8. Research with citizens on Calgary's economy
9. Human Capital Plan
10. Carry Forward of Operating Budget from 2015 to 2016 for Council Approval