Town of Comox Asset Replacement Funding Strategy

September 30 2023

Your City Solutions Inc, 3146 Mountain Highway, North Vancouver, BC

TOWN OF COMOX

Contents

Executive Summary

The Town of Comox is taking important steps toward managing the long-term sustainability of the community's assets and services. Financial stability is fundamental to the health of the community, and stable revenues and careful expenditure planning will ensure the Town's ability to consistently provide the services your residents need and enjoy.

The Town owns $270 Million (2023 replacement cost) of public assets that require replacement over time. Using Asset Management BC leading practices and the Asset HealthScoretm Framework the Town is moving from a 'Let's keep taxes low' to a 'let's keep assets healthy' outlook, while always considering affordability.

As part of applying the Asset HealthScore Framework to the Town's financial planning, asset data was compiled, replacement costs updated to 2023 dollars, and current funding levels determined. A risk profile, service level and debt financing approach was developed, and data was integrated with an asset replacement funding model.

The Town currently spends $4.2 Million per year on asset replacement or the equivalent of $493 in property taxes and utilities charged to a typical home. Town assets are in overall good condition. Approximately 4% of assets are past their service life and on average assets are 51% consumed or through their service life. This translates to an Asset HealthScore^{tm} of 94%.

Limiting asset replacement to the current $4.2 Million level of funding commitment is expected to reduce the condition of assets over the next thirty years. The proportion of Town assets past their service life in the next 30 years will increase from 4% to 25% and 73% will be fully consumed if funding levels are not increased from the current level. The Asset HealthScore^{tm} will reduce to 60%. This is not sustainable.

Three future financing scenarios for general, sewer and water capital fund assets were modeled to help the Town better understand the outlook if property tax funding was increased.

Scenario 1: Similar Risk and Level of Service

(94% Asset HealthScore^{tm}, property tax and utility funding target of $5.9 Million per year)

The goal of this scenario was to keep the risk and level of service as consistent as possible over the planning period. Under this scenario citizens could expect similar risk and level of service year over year for the duration of the period modelled. This scenario projects an increase in property taxes and utilities charged to a typical home from $493 to $939 over twenty years. This is equivalent to an average $22 increase each year or 1.0% increase in property taxes, 1.7% in sewer charges and 1.5% increase in water charges.

Scenario 2: Moderately increased Risk and Reduce Level of Service

(79% Asset HealthScore^{tm}, property tax and utility funding target of $5.1 Million per year)

The goal of this scenario was to moderately increase the risk of asset failure and increase the likelihood of a reduced level of service to better understand how investment levels are different than scenario 1 or 3. This scenario projects an increase in property

taxes and utilities charged to a typical home from $493 to $734 over twenty years. This is equivalent to an average $14 increase each year or 0.6% increase in property taxes and 0.6% increase in water charge each year.

Scenario 3: Increased Risk and reduced Level of Service
(72% Asset HealthScore^{tm}, property tax funding target of $4.7 Million per year)
The goal of this scenario was to further increase the risk of asset failure and likelihood of a reduced level of service to better understand how investment levels are different than scenario 1 and 2. This scenario projects an increase for a typical home from $493 to $617 over twenty years. This is equivalent to a $7 increase each year. An average 0.3% increase in property taxes and 0.2% increase in water charges each year.

While these increases are substantial over the long term, it is clear that a current funding gap exists. A long-term approach to reduce this gap through increased funding of a minimum 1.0% in property taxes for the next twenty years and 1.7% in water charges per year to a typical home will help protect those assets for future generations.

Accelerating this increase in funding over a much shorter period will increase the resiliency of the program and protect against inflationary replacement cost increases expected in the future.

Regards,

Cory Sivell, YourCity

Paul Murray, Brentwood Advisory Group

Introduction

For some households, financial sustainability is the day to day task of affording the essentials of a typical lifestyle - rent, food, entertainment, clothing, travel, medical etc. For those who own homes or businesses, financial sustainability often becomes a longer term consideration as planning shifts from the here and now to a time when mortgages are paid off or businesses sold to finance retirements.

Local governments need to think long term as well. Investments in infrastructure are significant and long term in nature and local governments continue in perpetuity to acquire and manage a stock of financial and physical assets that are critical for the provision of services to current and future generations.

> *A long-term financial plan is an essential tool for financial decision making. It provides information to guide decisions about the mix and timing of outlays on operating activities, renewal and replacement of existing assets, future additional assets, and the associated funding implications. It can be used to assess the expected future impact of financial decisions and to manage risks.*
>
> **Working for Local Government, Australia*

Long-term financial planning is the process of aligning financial capacity with the community vision and long-term service objectives. This is achieved for assets through development of a set of asset-related financial principles and an effective linkage to the community vision, strategic plan and financial plan.

How has the Town financially planned for asset replacement?

Similar to many local governments, the Town maintains a traditional rolling five-year capital program that forms part of the Annual Financial Plan approved by Council each year.

The Capital Program is refreshed annually; existing asset budgets are updated, and new ones added based on the availability of funding and competing short term priorities. Council periodically provides short term direction through the budget:

"Similar experience to other local governments"

"Assets built in the past with significant senior levels of government assistance"

"Inflation over lifecycle is significant"

"Gradual phase in of increased investment is the approach taken by many"

Debt financing is used sparingly. The primary driver of asset replacement is availability of reserve funding, current taxation and user fee charges.

Gas tax is used to supplement the program and has traditionally been allocated to replacement capital, such as road projects.

Grant funding applications are made on an ad hoc basis as programs become available, based on eligibility, Council support and staff capacity.

Challenges

Like many municipalities, the Town experiences pressures on its capital program:

- Funding is focused on the short term with priorities determined based on availability of funds and staff capacity
- Competition exists between operating and capital priorities for scarce taxation dollars
- Implementing a long-term approach presents the potential for large financial impacts
- Construction inflation is significant, and availability of contractors varies.
- Organizational capacity to increase asset replacement program over time.
- Climate Risks create additional pressure to use capital reserves for immediate repairs, improvements or rehabilitation.
- Debt is not normally viewed as a positive bridging tool for asset replacement.
- Relatively low levels of public awareness about the asset replacement funding gap and the implications for risk and service interruption in the future.

Current Funding Commitment

The Town currently charges a typical home approximately $2,640 per year in property taxes, sewer utility and water utility charges. Out of that $2,640 dollars, the equivalent of $493 each year is committed toward the replacement of assets. The balance of $2,147 funds all other municipal operations including fire, police, public works and administration.

Figure 1.0 below helps illustrate the total charges for a typical home for each component of the capital fund including the general capital fund (property taxes), water capital fund (water charges) and the sewer capital fund (sewer charges). Note that for the purposes of this analysis, sewer costs have been excluded as they are charged only to a small local area in the municipality. Figure 1.0 also illustrates what portion of the funds collected is currently used for capital versus operations. It is important to highlight that today, a majority of the funds collected are invested into operations and maintenance, particularly in the General Fund.

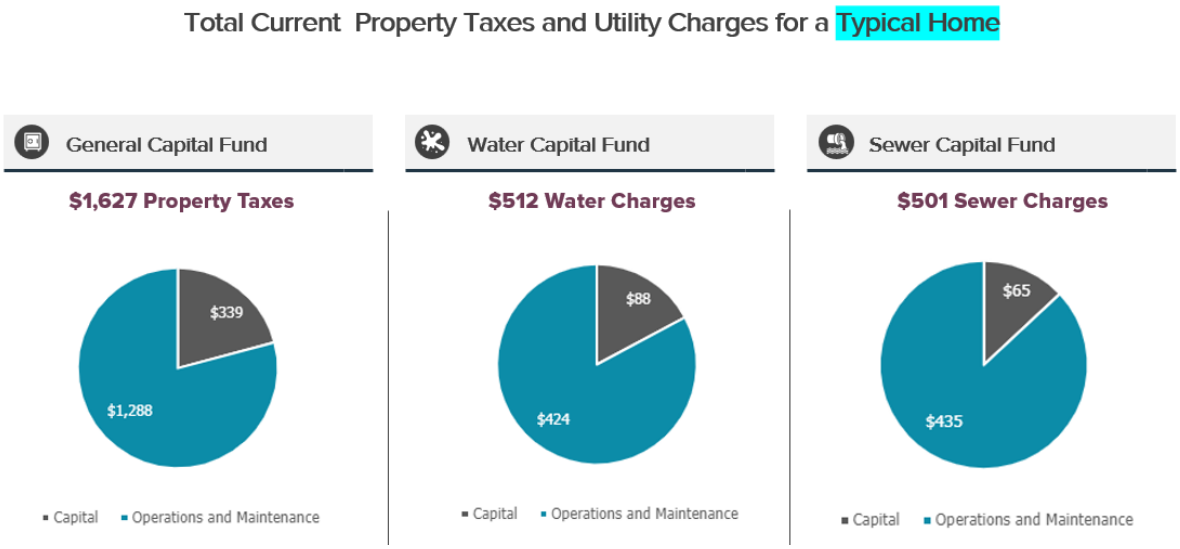


Figure 1.0: Property Taxes and Utility Taxes Summary

Moving Toward a Leading Practice Long Term Approach

Asset Management BC

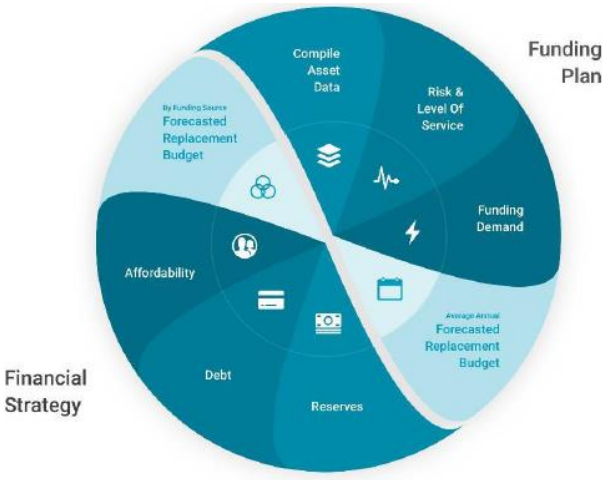
Using Asset Management BC's leading practices and the Asset HealthScore[tm] Framework, the Town is moving towards a long-term sustainable approach that ensures you can provide services to your citizens in a manner that reduces the need for large one-off tax increases in the future to pay for unexpected replacements.

Asset Management BC provides a leading practice roadmap to build a long term, sustainable approach, using three stages (Assess, Plan, Implement). The Town has completed the 'Assess' stage and this report will work on improving the Town's capacity in the 'Plan' stage of the framework.

Further work will be needed to implement the practices and to develop a measurement and reporting framework.

Asset HealthScore™

The Asset HealthScore™ Framework is a unique and proven approach that allows the Town to integrate and visualize the tradeoffs between risk, level of service and funding so that budgets can be set with confidence. Understanding the impact of today's funding decisions on the future health of community assets will help decision makers bridge the funding gap in a manner that serves the interests of the community.



Implementing an asset replacement funding plan and financing strategy will benefit the Town by:

- Reducing the likelihood for large one-off tax increases in the future.
- Promoting consistent and stable rate increases.
- Creating alignment between risk, level of service and cost.
- Improving community resilience in the long term.
- Minimizing risk of service interruptions from asset failures in the future
- Creating predictable, clear and consistent funding for asset replacement that is separate and distinct from funds needed for new community assets, and less subject to competing pressures from operating budgets.
- Improving accountability.
- Creating public awareness, transparency and accountability to the stakeholders.

Asset Replacement Funding Plan

Status Of Assets – Asset VitalSigns and HealthScore (The Bucket)

Maintaining the health of assets requires a rate of investment similar or faster than the rate at which asset deteriorate. This investment is like filling a bucket with water that is leaking from the bottom. The level of water in the bucket represents the overall health of the assets (i.e. Asset HealthScore). The closer the water is to the top of the bucket (i.e. higher the Asset HealthScore), the lower risk of asset failure and higher level of service is provided with the opposite being true.

By increasing the rate of investment beyond the rate of deterioration, the asset health would increase over time. This would be like filling the bucket faster than water is leaving. Conversely if you invest less into your assets than the rate at which they deterioration, your asset health will drop. This would be similar to filling the bucket at a slower rate than which water is leaving.

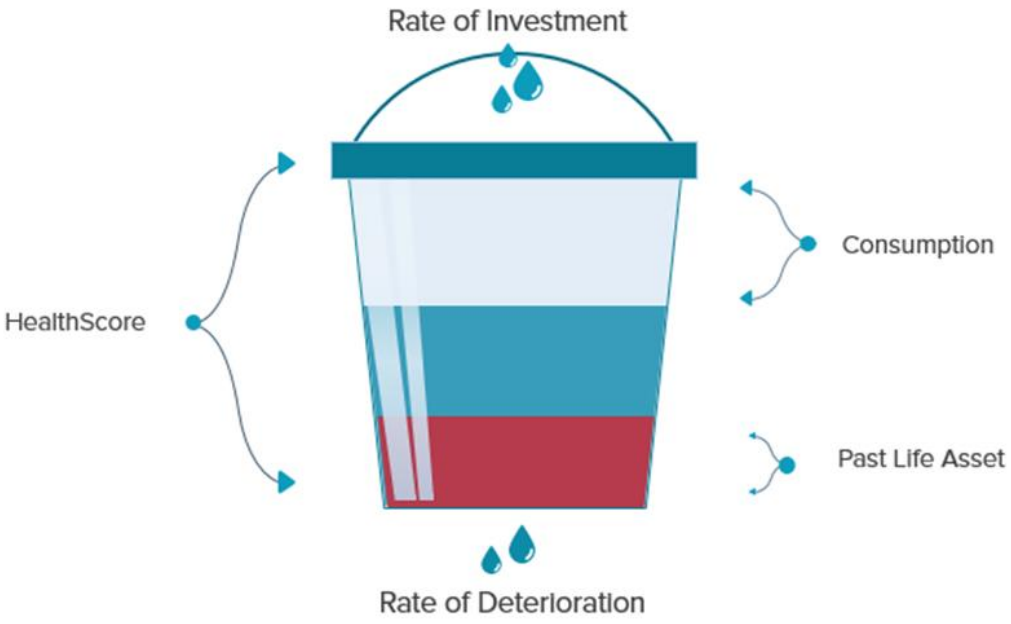


Figure 2.0: Asset Health Bucket Analogy

The Asset HealthScore™ represents the overall condition of the assets and is informed by two parameters including the Past life Asset Ratio and the Consumption Ratio.

The Past Life Asset Ratio represents the percentage of assets past their estimated life and the consumption ratio represents how far into the asset life span on average your assets are.

Today, the Town's assets are currently in overall very good condition with about 4% of assets past their service life and on average, assets are 51% consumed or through their service life. This translates to an Asset HealthScore™ of 94%

Example: You own a bike that has a 25-year life span and is worth $100. If the tires are worth $10 and are expected to last five years and they are currently six years old, 10% of the bike's assets would be past their life span because $10 of the $100 asset has passed its estimated life. In addition, the bike would be considered 20% consumed because it is five years into the 25-year life span.

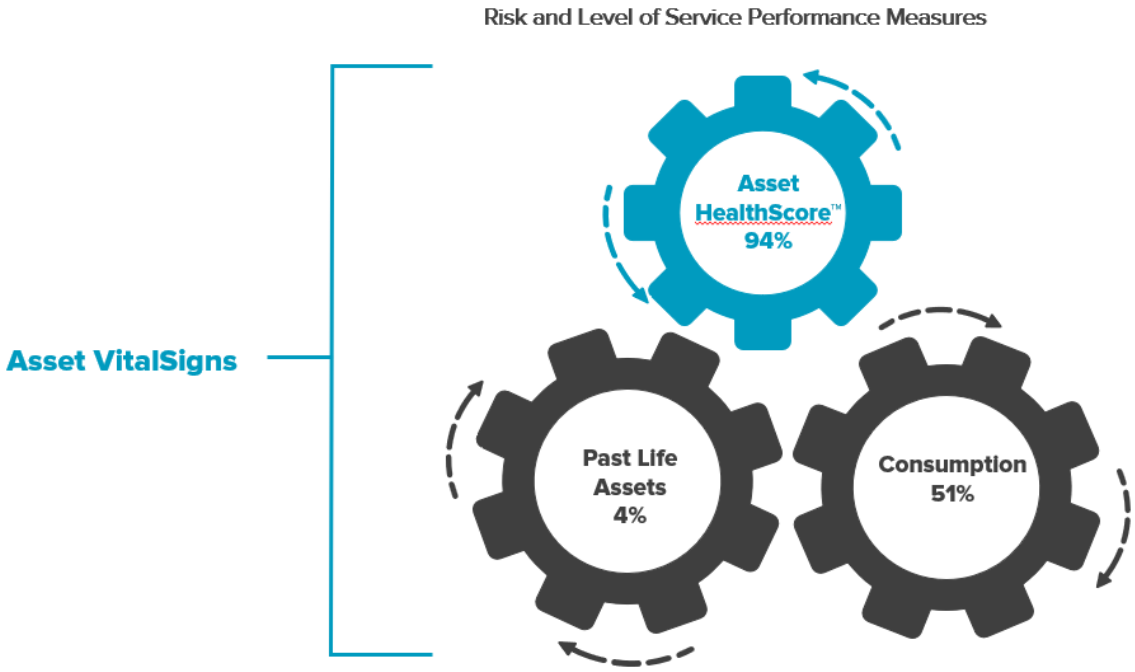


Figure 3.0: Summary of Asset Vital Signs (Asset HealthScore™, Past Life Asset Ratio, Consumption Ratio)

The Asset HealthScore[tm], Past Life Ratio and Consumption Ratio are used in this project to help inform the Town of the impact todays funding decisions have on the future health of assets. In general, as the Asset HealthScore ™increases, the risk of failure reduces and the level of service increases, and vice versa. When you invest more into assets, fewer of them are past their life span and consumed.

Overall, there is no right or wrong Asset HealthScore[tm] as it is highly dependent on the Town's desired asset risk and level of service, balanced against the ability to pay. During this project, the trade-off's between risk, level of service and cost will be explored to help provide context for decision making as it relates to asset replacement funding levels.

Connection between Funding and Asset Replacement Financing plan

The Town completed an Asset Replacement Plan in 2022/3 that identified various asset replacement budgets based on different risk and level of service scenarios. The Asset Replacement Plan did not focus on how the replacement budget would be financed but rather focused on establishing the target and showing the impact the funding targets have on future risk and level of service.

Below is a summary of work completed as part of the Asset Replacement Plan.

1. **Asset Data Compiled:** A single asset inventory was established that can be used for high level asset management planning purposes.
2. **Impact Risk and Service Level Frameworks Built:** Frameworks were developed to help the Town understand how risk and level of service will be measured and workshops were completed to assess the possible desired future states. The risk and level of service scores were translated into a Sustainable Service Delivery Score that could be used to help prioritize funding by asset category.
3. **Funding Demand Calculated:** The funding demand was calculated for each asset category based on when assets were estimated to past their life spans. The funding demand graphs illustrate the general profile of when assets need to be replaced which helps inform the timing of investments.
4. **Forecasted Asset Replacement Budget Established:** Various replacement budgets were presented based on different risk and level of service scenarios.

With a forecasted asset replacement budget in place, a strategy to finance the replacement budget was developed using a mix of taxation and utility charges, debt financing and reserves. The financing strategy was built using an Asset Sustainability Framework.

Asset Replacement Financial Strategy

Moving from Asset Replacement Funding to an Asset Replacement Financing Strategy

We transition from the replacement plan to a financing strategy using a gradual phase-in approach over the longest period of time to meet the replacement funding target, while maintaining the Asset HealthScore™ with debt financing, reserves etc. This is the framework shown in figure 4.0 below.

The asset replacement financial strategy is based on an Asset Sustainability Framework of three pillars - Resiliency, Flexibility and Affordability.

Resiliency is the Town's ability to continue meeting your desired service levels within your risk tolerances, over the long-term and in a stable manner.

Flexibility is the Town's ability to use reserves and debt to fund both planned and unplanned asset replacements.

Affordability is the extent to which taxpayers can afford the cost of asset replacement.

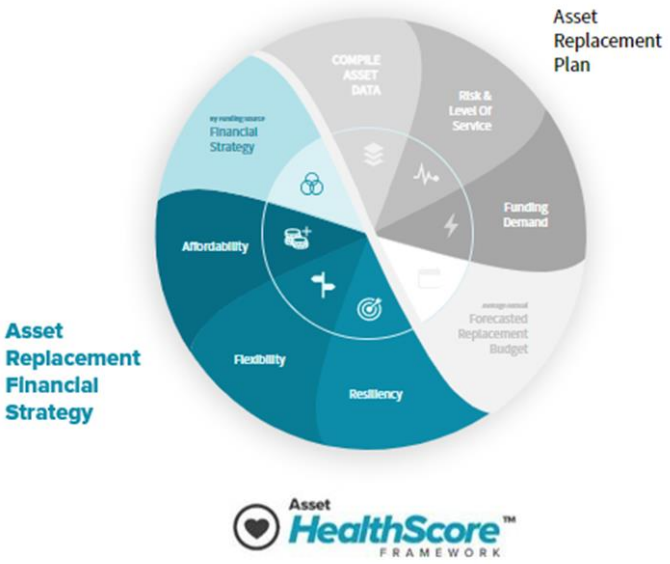


Figure 4.0: Asset HealthScore[tm] Framework

Figure 5.0 below helps to illustrate the Asset Sustainability Framework, including the indicators that are used to measure each part of the framework.

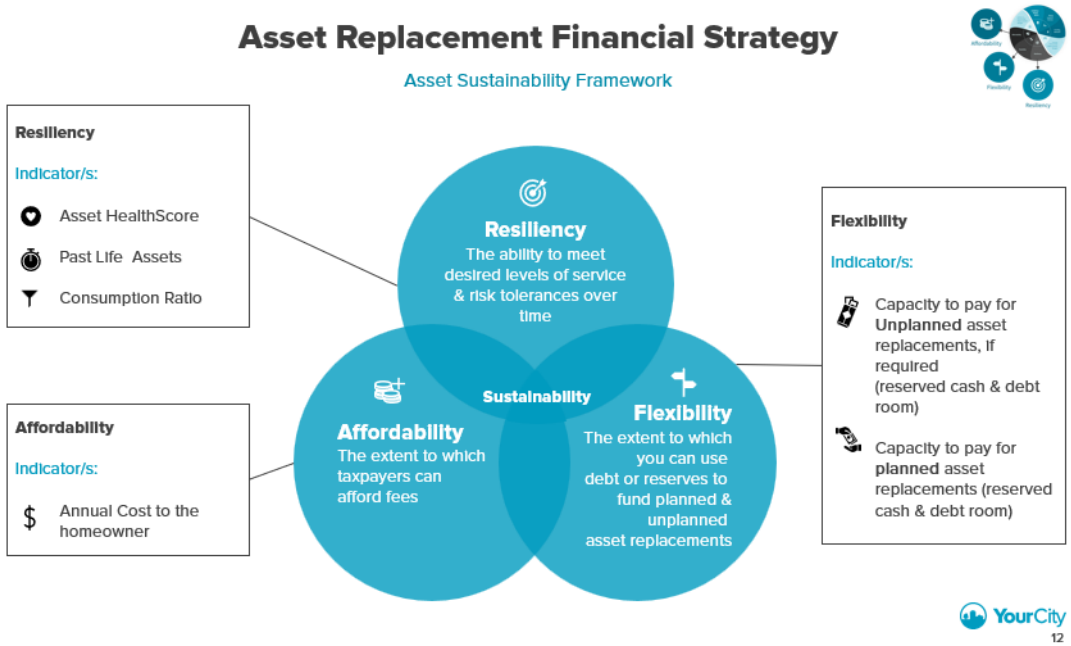


Figure 5.0: Asset Sustainability Framework

In a workshop setting YourCity staff worked with Town staff to review and set constraints for each of these pillars to help inform the development of the financial strategy.

Resiliency

Resiliency is measured using the Asset HealthScore™ and is the Town's ability to continue meeting its desired service levels within its risk tolerances over the long term, and in a stable manner. The higher the Asset HealthScore™ indicates more resilient assets.

We know that maintaining the current level of asset replacement investment is not a resilient or sustainable approach. Not increasing funding will mean that assets will continue to age such that 25% of all assets will be past useful life over the planning period. As a result, risk of failure and service interruption will increase. Consumption of assets will continue to increase to the point that 73% of assets are fully consumed (at the end of their useful life) and many will be significantly beyond that condition, which is also high risk. The Town Asset HealthScore™ is forecast to reduce to 60% from 94% in that circumstance.

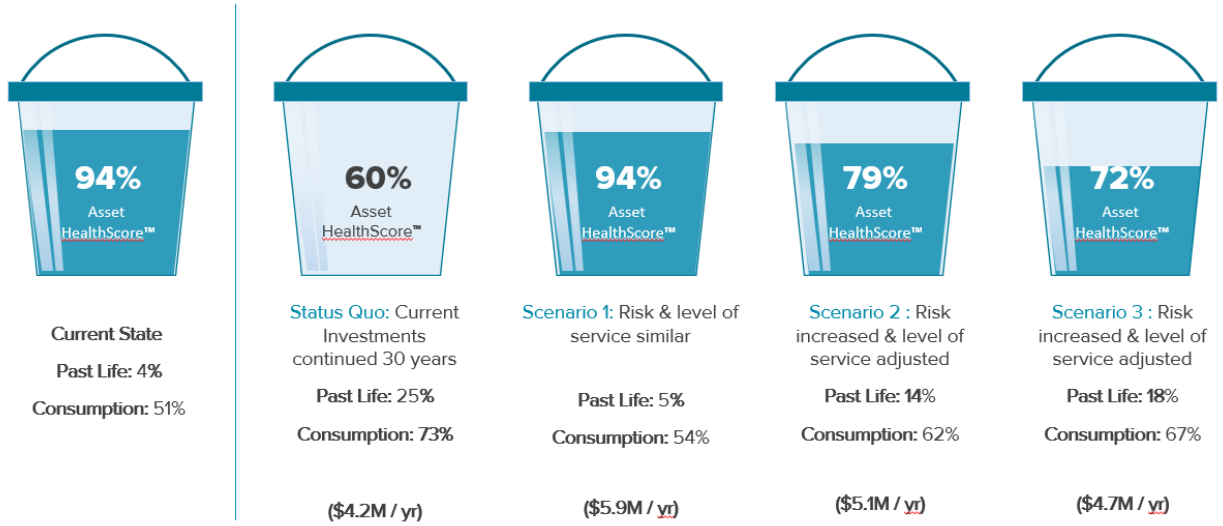


Figure 6.0: Resiliency scenarios for General Capital Fund Assets

Town staff determined that they would like to consider scenarios 1, 2 and 3 for the General and Water Capital Funds, as part of the financial strategy.

Affordability

The affordability of the scenarios modelled is measured by the cost to the typical home for asset replacement. In 2023 the cost in property taxes and utilities to a typical home is $2,640 of which $493 is allocated to capital asset replacement shown below in figure 7.0

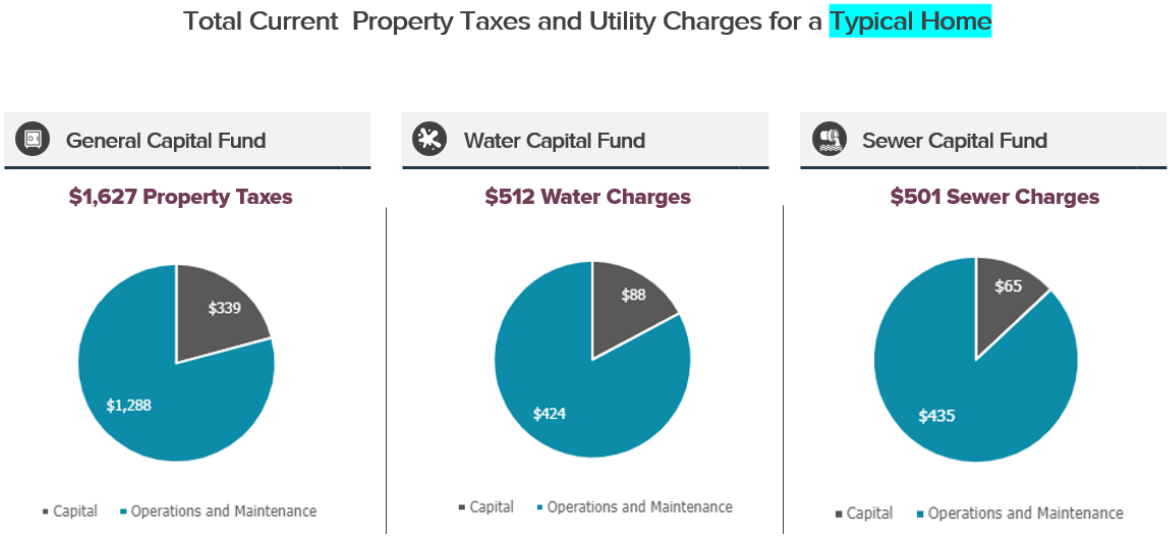


Figure 7.0: Cost to a typical home for general, sewer and water capital funds

Flexibility

Flexibility is the extent to which debt and reserves can be used to fund planned and unplanned asset replacements. Increased flexibility reflects an increased ability to pay for planned and unplanned replacement without unexpected increases to property taxation and rates. Increased flexibility mitigates potential for unexpected tax increases, but it also requires saving excess funds today for failures that may or may not occur in the future. Given these factors, it is important to balance the desire for flexibility with affordability impacts.

The Town has $270 million of assets at current replacement cost. Past life assets represent 4% of that or $12.1 million dollars. After workshop sessions, staff determined they would like to protect or insure against an asset failure or unplanned replacement by retaining $2.4 million in funding capacity at all times over the planning period. $2.4 million would come from reserves and $0.0 million from debt.

It is important to highlight that funds protected in a reserve are more liquid, meaning they can be deployed faster whereas reserved debt capacity is less readily accessible as a borrowing bylaw must be created to access funds.

Figure 8.0 illustrates the numbers explained above.

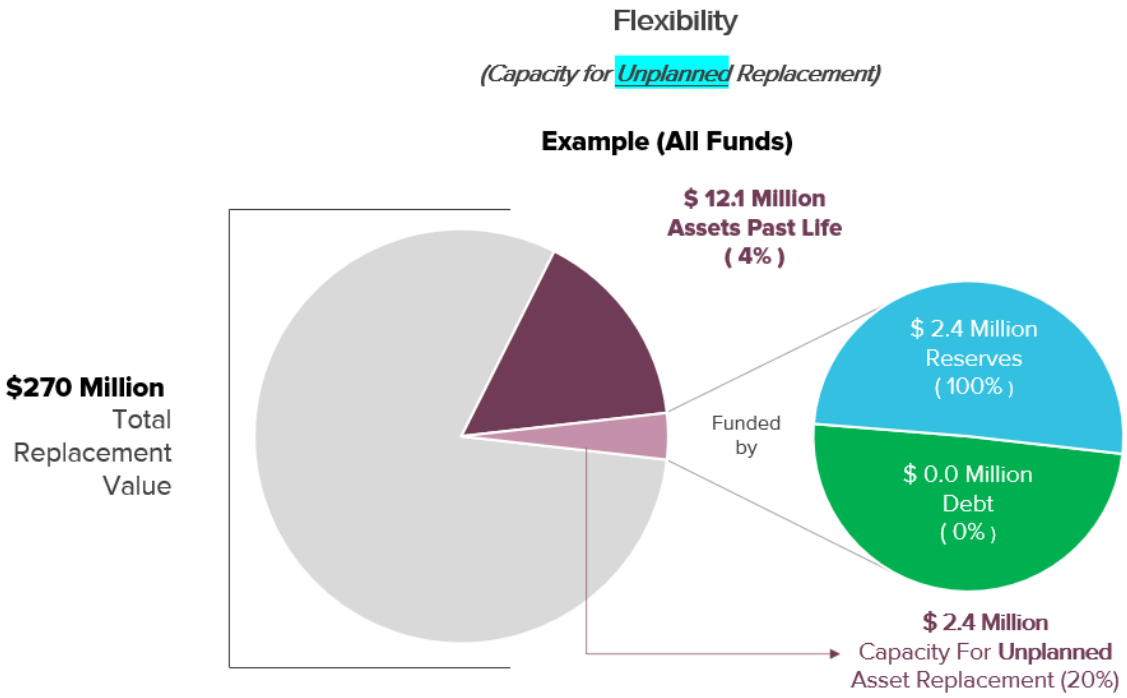


Figure 8.0: Capacity to fund unplanned asset replacements

In addition to unplanned asset replacement, the Town also has debt servicing capacity that can be accessed (subject to Elector and Council approval) for the planned replacement of assets. Using a combination of debt financing and reserves can reduce the annual cost to the taxpayer over time in comparison to a fully pay as you go cash approach.

To determine the amount of debt that can be allocated for planned asset replacement, the Town determined how much of their total debt capacity may be needed for other purposes outside of planned replacement. In particular, the Town explored how much debt room would need to be reserved for emergencies and new projects, in addition to the amount of debt room that is allocated for unplanned replacement.

The Town currently has a total of $67.1 million of legislated annual debt servicing room. After considering the desire to allocate $0.0 million for unplanned replacement, $5.0 million for emergencies and $35.0 million for new projects, this leaves $27.1 million for planned asset replacement projects.

Figure 9.0 helps illustrate the total debt capacity today and what portion of the debt capacity is allocated to unplanned and planned replacement, new capital projects and emergencies.

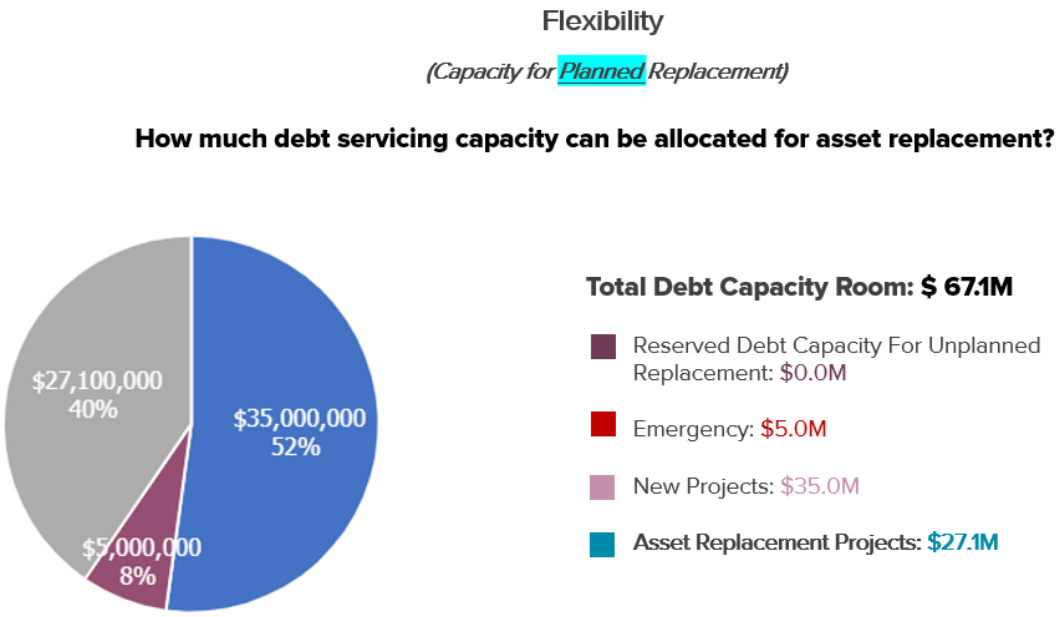


Figure 9.0: Debt capacity available for planned asset replacement

It is important to note that over time the Town's overall debt capacity increases as revenues increase and as a result the amount of debt capacity available for asset replacement, emergencies and new projects increases as well. Therefore, in the financial strategy the percentage allocation was used to determine the amount of debt capacity that can be allocated rather than the current dollar presented.

This approach to reserve debt capacity for unplanned and planned replacement, emergencies, and new projects, provides the City with the capability to respond financially when these situations occur without a significant tax increase or budget/service impact in any one year. This is a resilient approach.

Important Assumptions and Principles

The Asset Replacement Financial Strategy is based on a number of assumptions and principles including:

1. Planning period of thirty years.
2. Like for like replacement only: The model was developed only considering like-for-like replacements and does not consider level of service increases, regulatory requirements, or technology changes.
3. Constant dollar analysis: The model was developed using constant dollar analysis - meaning inflation is to be accounted for annually based on actual values.
4. Affordability: The strategy always seeks to phase in cost increases over the longest period possible to smooth the financial impacts to the taxpayer.
5. Resiliency: The strategy remains within the target Asset HealthScore^{tm}, past life and consumption ratio values defined in each resiliency scenario modeled.
6. Flexibility:
    a. Unplanned Asset Replacement
        i. Keep a minimum reserve level over the planning period equal to a portion of the assets past their life spans.
        ii. Maintain debt capacity over planning period equal to a portion of the assets past their life.
        iii. If reserves fall below the minimum level, save until the minimum level is met .

    b. Planned Asset Replacement
        i. Use a mix of reserves and debt to smooth out tax impacts over time.
        ii. Reserves will be used first and then debt will be used as needed.

Scenario Models

Based on discussions with staff, three scenarios were modelled to help illustrate the difference between three possible risk and service levels and the financial impact those scenarios have on the community.

Scenario 1: Similar Risk and Level of Service
(94% Asset HealthScore™, funding target of $5.9 Million per year)
The goal of this scenario was to keep the risk and level of service similar over the planning period. Citizens could expect similar risk and level of service today and in the future.

Scenario 2: Increase Risk and Reduce Level of Service
(79% Asset HealthScore™, funding target of $5.1 Million per year)
The goal of this scenario was to slightly increase the risk of asset failure and increase the likelihood of a reduced level of service to better understand how investment levels are different than scenario 1 or 3.

Scenario 3: Reduce Risk and Increase Level of Service
(72% Asset HealthScore™, funding target of $4.7 Million per year)
The goal of this scenario was to further increase the risk of asset failure and increase the likelihood of a reduced level of service to better understand how investment levels are different than scenarios 1 and 2.

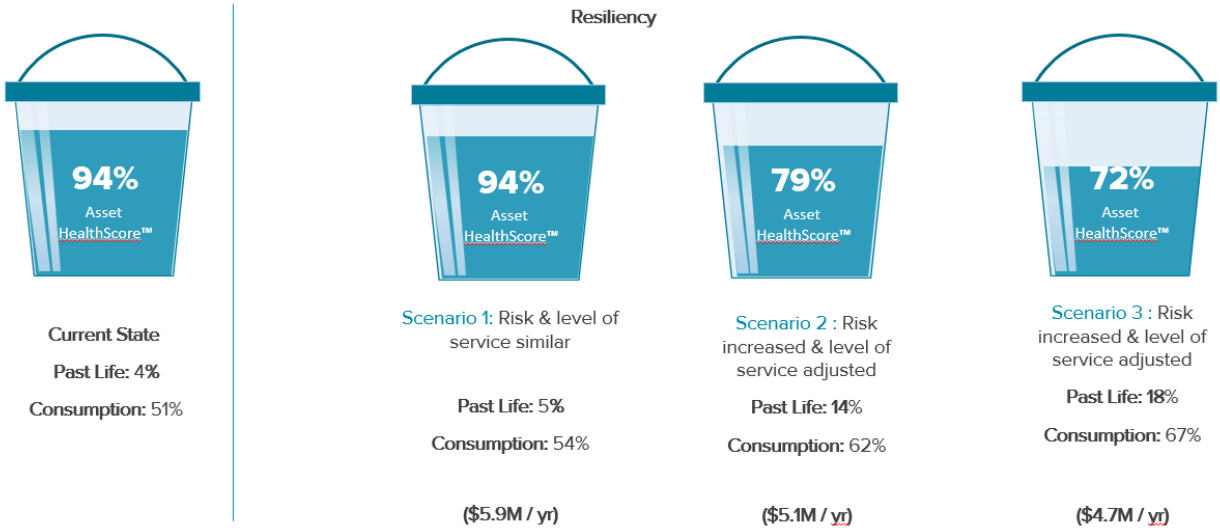


Figure 10.0 illustrates the three scenarios modeled in the Town's financial strategy.

Scenario 1 requires an annual investment of $5.9 Million, an increase of $1.7 Million over the current investment of $4.2 Million. This will maintain past life assets and asset consumption consistent with current levels. The longest period over which this can be phased in is 20 years and it requires an increase to the typical home of $37 in the first year, $29 in the next 4 years and $20 for the remaining $15 years. Annual cost rises from $493 to $939 per year and during that time 10% of debt capacity is used to bridge asset replacement and minimize cost to residents.

This is equivalent to a 1.0% property tax, 1.5% sewer charge increase, and 1.7% water charge increase to the typical home each year.

Figure 11.0 illustrates the financial impact of scenario 1.

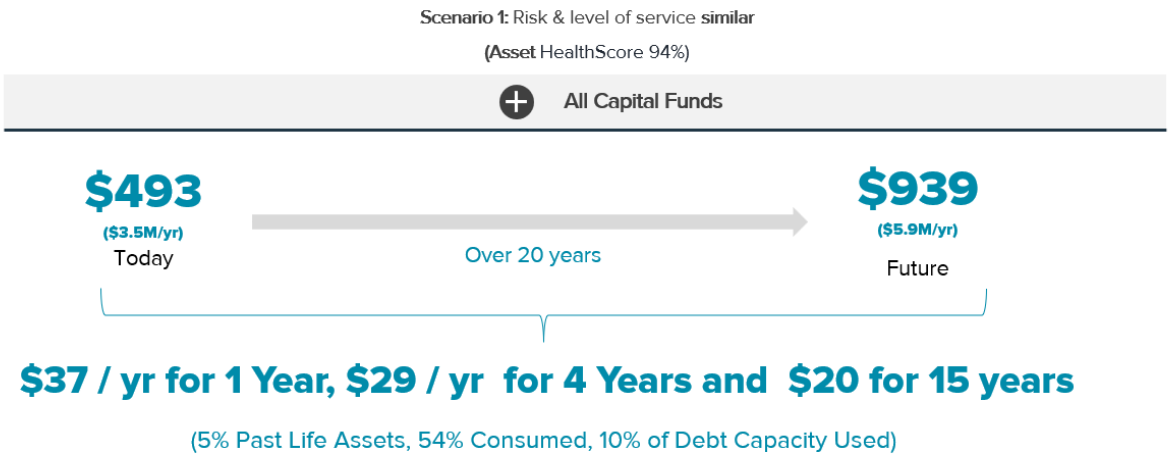


Figure 11.0: Financial Impact of Scenario 1

Scenario 2 requires a lower annual investment of $5.1 Million, an increase of $0.9 Million more than the current investment of $4.2 million. This will increase the proportion of past life assets to about 14% and asset consumption will rise to 62%. The longest period over which this can be phased in is 20 years and it requires an increase to the typical home of $14 for the first 5 years and then $11 for the remaining 15 years.

Annual cost rises from $493 to $734 per year and during that time 5% of debt capacity is used to bridge asset replacement and minimize cost to residents.

This is equivalent to a 0.6% property tax and 0.6% water charge increase to the typical home each year. There is no change in the sewer charge.

Figure 12.0 illustrates the financial impact of scenario 2.

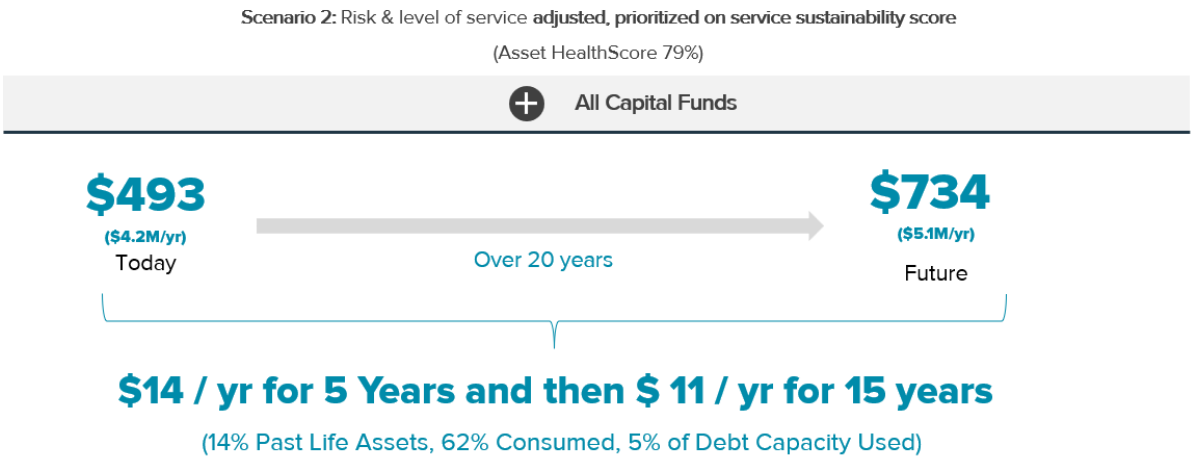


Figure 12.0: Financial Impact of Scenario 2

Scenario 3 requires a lower investment of $4.7 Million, an increase of $0.5 Million more than the current investment of $4.2 million. This will increase the proportion of past life assets to about 18% and asset consumption will reach 67%. The longest period over which this can be phased in is also 20 years and requires an increase to the typical home of $7 each year. Annual cost rises from $493 to $617 per year and during that time 4% of debt capacity is used to bridge asset replacement and minimize cost to residents. This is equivalent to a 0.4% property tax and 0.2% water charge increase to the typical home each year. There is no change in sewer charge.

Figure 13.0 illustrates the financial impact of scenario 3

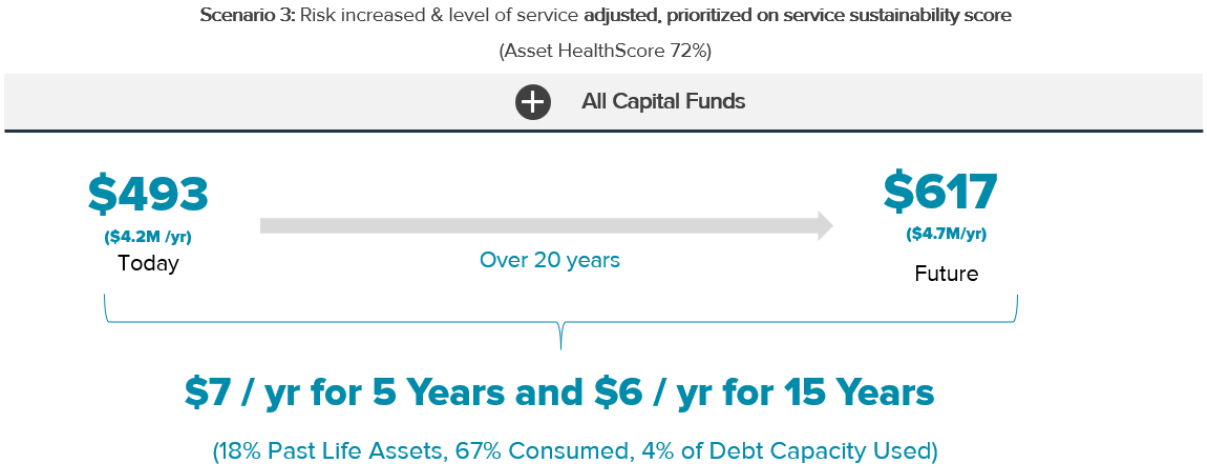


Figure 13.0: Financial Impact of Scenario 3

Summary

The Asset Replacement Financing Strategy creates alignment between risk, level of service and finances. It is a living strategy which is intended to be used each year during the budget process to assist Council in making choices about asset replacement, risk of asset failure and service impact. It is a guide for decision making, not a bylaw.

The strategy sets a path forward and each year allows Council to balance affordability with risk and level of service to determine the level of asset replacement that can be funded.

In this instance, a typical Town of Comox household can expect a cost increase of between $7 and $37 per year depending on the scenario modeled. This translates to an increase in property taxes of approximately 1.0% each year and increases in water charge of up to 1.7% per year, a short term 1.5% increase in sewer charge and the use of relatively modest levels of debt.

While these increases are substantial over the long term, it is clear that a funding gap exists. A long-term approach to reduce this gap through increased funding will protect those assets for future generations and increase the Town's resilience.

Accelerating this increase in funding over a much shorter period will increase the resiliency of the program and protect against inflationary replacement cost increases expected in the future.

Next Steps

Next steps will include integrating the Asset Replacement Financial Strategy approach into the Town's annual budgeting process, 5 year financial strategy and 5-year capital plan including:

- Considering year one of the strategy during the budget process.
- Considering the impacts of accelerating the scenarios and construction cost inflation.
- The separation of property tax rates into two components, asset replacement and general operations, to improve communication and ease of understanding.
- Regularly reporting on the status of the Asset Replacement Financing Strategy each year during the budget process and the annual report.
- Reformatting budget documents to more clearly separate capital costs/funding from operating costs/funding making them easier to communicate and understand.

Thank you for considering the information within this report. If you have any questions, please do not hesitate to contact the undersigned.

Regards,

Cory Sivell, YourCity

Paul Murray, Brentwood Advisory Group