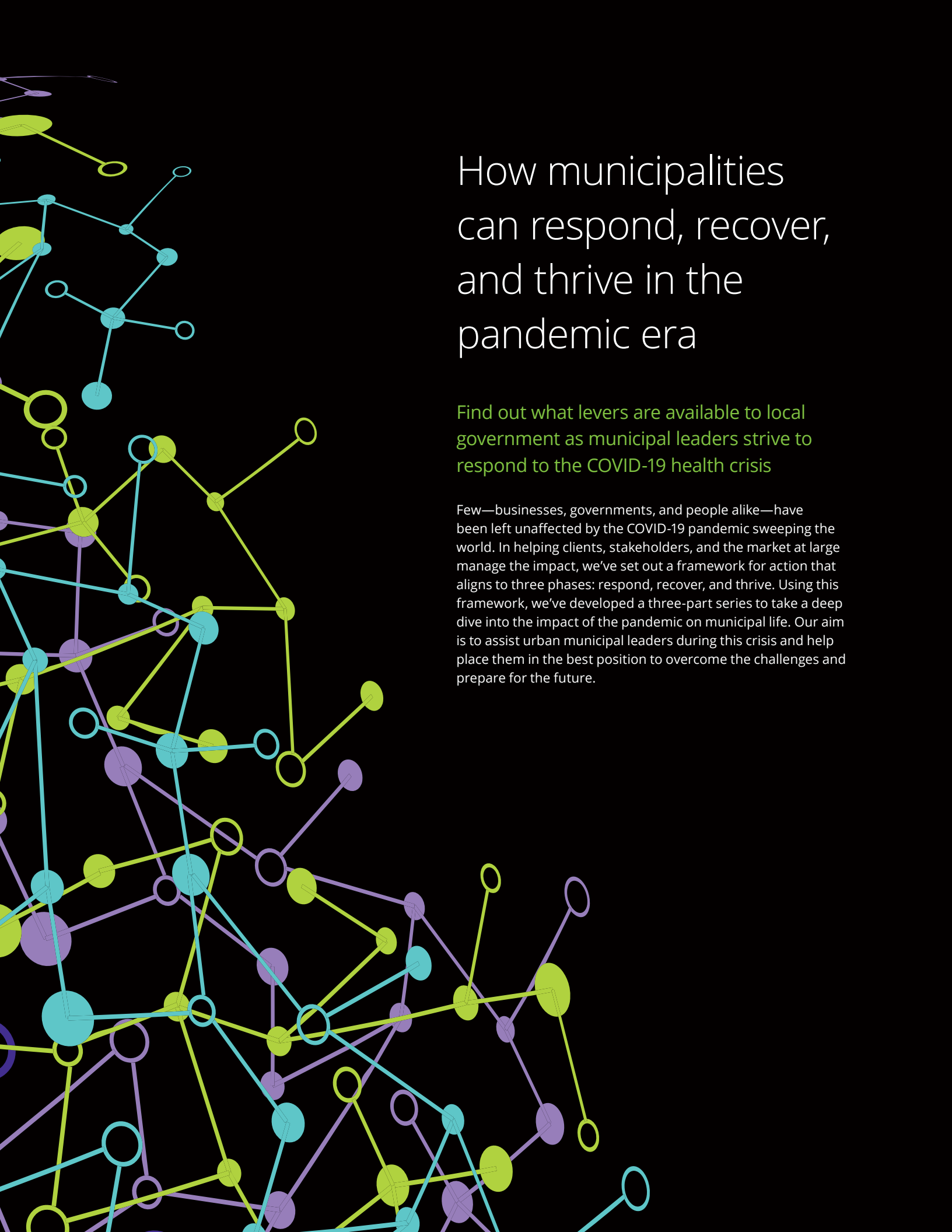


COVID-19

How municipalities can respond, recover, and thrive in the pandemic era

Phase 1: Respond



How municipalities can respond, recover, and thrive in the pandemic era

Find out what levers are available to local government as municipal leaders strive to respond to the COVID-19 health crisis

Few—businesses, governments, and people alike—have been left unaffected by the COVID-19 pandemic sweeping the world. In helping clients, stakeholders, and the market at large manage the impact, we've set out a framework for action that aligns to three phases: respond, recover, and thrive. Using this framework, we've developed a three-part series to take a deep dive into the impact of the pandemic on municipal life. Our aim is to assist urban municipal leaders during this crisis and help place them in the best position to overcome the challenges and prepare for the future.



What do the crisis stages mean for municipalities?

Respond:

Dealing with the immediate public health crisis while maintaining service continuity. Most municipalities are currently in this phase, although some provinces are starting to relax the initial lockdown measures. Critical in this unique and uncertain environment is learning from other jurisdictions that have advanced experience with COVID-19.

Recover:

Addressing all aspects of the economy, public health, social norms, and end-to-end municipal operations. The prime minister has indicated this phase will be characterized by a high degree of vigilance rather than a return to normalcy. While most jurisdictions are still responding to the crisis, we're seeing signs of recovery in Canada and around the world. We believe the recovery timeline will stretch into years, but managed well, it will position municipalities and towns to thrive in the long term.

Thrive:

Becoming stronger, more resilient communities, with an economy that's better prepared for a highly uncertain future. No jurisdiction has yet moved to this stage, but some are already taking action to position themselves for it. We believe that for Canadian municipalities to thrive, a new model of local government will need to be formed that shifts historical patterns of service delivery, funding, and roles between levels of government.

In this paper, the first of the series, we'll discuss what urban municipalities should consider as they work through the latter stages of the respond phase and explore viable options for managing continuity while coping with economic turmoil. This work is based on secondary research, experience and conversations with municipal clients across Canada.



Phase 1: Respond

The spread of COVID-19 continues to affect communities and urban ecosystems, propelling municipal governments to the centre of this public-health, social, and economic crisis. Drastic decisions, such as closing businesses and public facilities as well as encouraging physical distancing, have supported the goal of “flattening the curve” of infection rates, but it has been at a significant cost to municipalities.

Municipalities throughout Canada are now reporting a significant loss of revenue,¹ pushing many to the brink of their financial capacity. The Federation of Canadian Municipalities estimates that cities will see a large budgetary shortfall in 2020, assuming physical distancing measures last six months. This impact will be made more acute by the fact that most municipalities are currently obliged to absorb an operating deficit in their following year’s budget. In addition, they’re limited in the amount of funds they can borrow to cover operating costs, as these are directly related to the amounts collected via tax, and government grants in the current year.

The crisis has also exposed major flaws in the resilience of the traditional governance and financing capabilities of municipal governments, particularly their ability to cope with economic turbulence.

The intention of this paper is partly to promote discussion among officials, both provincial and municipal, on how they might go about addressing the following questions:

- What is the actual impact of COVID-19 on municipal operations? Can it be measured?
- How should citizens be supported with essential services?
- How much longer might it be before municipalities become insolvent?

- What actions can municipalities take to improve their financial position if federal or provincial support is insufficient?
- What can be learned from other jurisdictions? What global insights might be relevant?

Municipal governments need to quantify and forecast the consequences of COVID-19 on their communities to re-establish financial control. The following sections outline a recommended approach for assessing, quantifying, and forecasting the impact on operations, and provide strategies for restoring financial control by focusing on the elements that municipalities are able to, and should, control.

The respond phase has put municipalities in a difficult financial position. To re-establish financial control and avoid insolvency, municipalities need to quantify and forecast the impact of COVID-19.

¹ Selected examples: The City of Toronto is losing \$65 million per week and anticipates losing nearly \$800 million by the end of a 12-week lockdown, representing 6 percent of its operating budget (<https://nationalpost.com/news/cities-bleeding-cash-because-of-covid-19-could-be-next-financial-domino-to-fall-for-federal-government>); the City of Ottawa anticipates losing up to \$273 million by December, representing 10 percent of its operating budget (<https://ottawacitizen.com/news/local-news/city-of-ottawa-faces-nine-figure-revenue-hit-because-of-covid-19-restrictions/>); the City of Calgary is losing \$15 million per week, representing 10 percent of its operating budget (<https://edmonton.citynews.ca/2020/04/13/cities-canada-shortfalls-covid-19-crisis/>) the City of Vancouver has announced it is at risk of going bankrupt and is preparing for a loss of \$189 million this year, and potentially an additional loss of \$325 million if people default on property taxes, representing up to a third of its operating budget. (<https://edmonton.citynews.ca/2020/04/13/cities-canada-shortfalls-covid-19-crisis/>)



Understand today's position

To make informed, complex decisions on what they could and should do, municipal leaders must have an accurate view of their cash positions as well as an understanding of the repercussions of COVID-19 on their balance sheets. They should conduct a cash-flow analysis to take into account the following changes in inputs:

Revenues

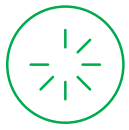
Typical sources of revenues, such as taxes and services fees, are down and will continue to be at risk. Property taxes will become uncertain as the economy contracts and defaults begin, by both residents and commercial owners. The full extent of default payments is uncertain; however, as of late April, 7.1 million Canadians—about 19.6 percent of the total population—had applied for the Canadian Emergency Response Benefit (CERB). Revenues derived from fees (e.g., public transportation, usage of recreation facilities, parking, fines, and permits) are now nearing zero as a result of limited economic activity due to self-isolation and emergency orders in many jurisdictions.

Municipalities should also anticipate changes in the timing of revenue collections. As an example, commercial owners might defer tax payments altogether, or pay a portion now and the remainder once economic activity resumes to a certain level. Understanding what economic factors will affect the ability of residents and businesses to pay their taxes will be critical. Relying upon traditional methods of economic projection during this extraordinary time will result in an incomplete and incorrect analysis.

Expenses

Expenses remain high, and may even continue to increase. Local governments have had to execute numerous response initiatives to support their citizens and communities, all of which require funding. While the majority of businesses and public facilities may be closed, the more costly public services—such as waste management, water treatment, and public transit—remain in operation. Physical distancing measures have created additional expenses, such as rapid investments to set up employees who could work from home (e.g., purchase of hardware, software, and licences) and continued paycheques—or at least benefits maintenance—for employees whose roles have had to be suspended.

Getting a clear view of the current cash-flow position is the first step in gathering accurate data to support decision-making on initiatives to improve municipalities' financial position. The next step is to get a sense of how liquidity may fluctuate in the next few months and to focus on the costs that can be controlled.



Assess what might happen next

While there is no modern playbook for a crisis such as the COVID-19 pandemic, thoughtfully assessing what might happen over the next few months can go a long way toward effectively managing the continuity of key services and overall financial position. Once an initial cash flow has been built, we recommend modelling different public-health and economic scenarios to drive plausible views of potential cash requirements, shortfalls, and their expected timing.

By implementing a scenario-based modelling approach, municipalities get an unbiased, fact-based analysis to better prepare for uncertainty and limit risks to their operations, communities, and economy. Scenario-based models should include inter-jurisdictional insights, lessons learned from other geographies, and best- to worst-case pandemic scenarios.

As it can be daunting to synthesize and model vast amounts of information into planning the scenarios, the following is a curated view of the local and macro factors to be considered:

Micro factors

Local factors will be specific to each municipality. Each should be detailed as adjustments to the current operating budget. For example:

- How have revenues and revenue sources changed, and might they continue to change?
- How has spending changed, and may continue to change? Has the cost to deliver essential services increased?
- What special measures have or will be implemented (e.g., tax payment deferral), and what is the estimated uptake (e.g., 25 percent)?
- What spending changes related to staffing have taken place (e.g., what benefits will need to be paid, is financial support related to remote work expected to increase or decrease)?
- What is the timing of any decisions that may affect cash flow (e.g., council is expected to vote in four weeks about reducing service level)?

Macro factors

Macro trends range from emerging behaviours observed in countries that are several weeks ahead on the recovery curve to health-related developments, such as the likelihood of future outbreaks or the approval of a vaccine. Consider how these might shape and inform the best-case, worst-case, and other scenarios. Municipalities should also predict how future macro developments might affect their local activities, considering the impact of business operations, consumer behaviour, the movement of people, and future public-health developments.

Leading jurisdictions are working already on scenario-planning, using knowledge, insights, and experience from around the world to develop different pandemic and economic scenarios, such as:

- The pandemic eases in the spring or early summer, leading to a rebound in the economy this fall or winter and a gradual recovery next year.
- Waves of infection last through the summer and into the fall, keeping Canada and the United States in crisis mode for months. This scenario could be consistent with either a long recession or a double-dip recession.

A scenario-based modelling approach will enable municipalities to be better prepared for uncertainty and limit risks to their operations, communities, and economy.

Addressing key questions

What restrictions on businesses and individuals might be lifted, and when? What will travel look like in the fourth quarter of 2020, and how might that affect sectors (trade and tourism, for example) and their recovery? Will there be future outbreaks of the virus?

Using the examples of Seoul, Rome, or Wuhan can provide great insights into what the future may look like.





Layer what can be influenced into scenario planning

The response to COVID-19 has been driven by all levels of government, with certain aspects of it falling under the purview of municipalities. Below is a four-step framework for municipal leaders to identify, assess, and act on key items to improve cashflow and fiscal stability. This is an iterative process which should be factored into the scenario planning.

Define essential services

City governments have always put citizens first, and are wired to deliver consistent and comprehensive services. In the midst of this pandemic, they need to review and define essential and non-essential services, and determine reasonable service levels for each. By clearly defining essential services, decisions on cost reductions can be rooted in confidence that the municipality will continue to meet the most critical needs of its citizens.

Public Safety Canada, for one, has issued guidance on what constitutes an essential service and function during the COVID-19 crisis, defining them as the processes, systems, facilities, technologies, networks, assets, and services essential to the health, safety, security, or economic well-being of Canadians and the effective functioning of government.²

Municipalities should perform a detailed and unbiased analysis of their current service provision, and identify what is essential and what can be put on hold or reduced. In these uncertain times, layoffs, voluntary work reductions, service reductions, or service elimination cannot be excluded from consideration. The newly defined service levels should be included in the scenario analysis and remain in place for at least the respond phase, if not longer.

Target variable costs

Municipalities are facing tough decisions on where to cut back to improve their financial outlooks, as not all changes to services will result in the same financial impact. Reducing variable costs is often a quicker way to immediately reduce cashflows than focusing on fixed costs. Each consideration should be modelled within the scenarios developed earlier in this paper. The objective is to make the necessary changes to improve the financial outlook within the limits of providing critical services. Each change should be modelled within the scenario planning.

Reduce non-essential services with variable costs

The impact on cash flow of reducing or temporarily stopping non-essential services should be evaluated. Services provided by contractors—which could include greenspace landscaping and maintenance, sidewalk snow clearance, or a customer service desk—may provide options.

Cut discretionary spending

The unfortunate fact is that this is not business as usual. Discretionary spending should be restricted. This could include:

- Pausing or cancelling special projects, including capital projects
- Imposing hiring freezes
- Reducing contract labour and redistributing work to the permanent workforce
- Encouraging employees to take available leave balances to reduce liabilities on the balance sheet

² <https://www.publicsafety.gc.ca/cnt/ntnl-scrtr/crtcl-nfrstrctr/esf-sfe-en.aspx>

Make resources go further

Municipal governments should carefully evaluate, by means of targeted analysis, their current resources to ensure that each person and dollar is being as effective as possible. Any improvements should be considered in the scenario planning. They can look to extend their resources in the following ways:

Redeploy existing resources

As the focus shifts to essential services, the capacity required for these services increases. Municipalities may have already met the need of increased capacity through contractors. A lower-cost alternative is to redeploy the existing workforce to deliver essential services. This may also prevent laying off non-essential workers, which will better position the municipality for the recovery phase.

Evaluate the frequency of essential services

Municipalities can look to do more with their existing resources by reducing the frequency of services. Although citizens may expect weekly garbage pick-up or bus service every half hour, reducing the frequency of these will reduce variable costs and allow resources to be reallocated to other essential services.

Focus on cash management

Under normal conditions, municipalities primarily focus on delivering services to citizens. Routine back-office activities such as paying bills and turning receivables into cash are often taken for granted. In the current abnormal conditions, however, smart organizations are shifting their focus to ensure their back-office activities are well-run in order to prevent unnecessary constraints on cash resources.

Municipalities should look to extend payables by communicating directly with suppliers to negotiate the easing of contract terms—including extending payment deadlines or reducing ordered quantities to use up existing inventories.

Although municipalities understand their taxpayers are facing difficult times, lifting barriers to the payment of property taxes and other municipal invoices can increase payment receipts for those who do have the ability to pay. Simply invoicing accurately, being responsive to citizen inquiries, and directing citizens to online payment solutions can increase cash inflows through the collection of normal municipal revenue sources.

Mitigate impacts on cash flow

Canadians still don't know if and when activities will resume to their pre-pandemic levels, and the possibility of localized flare-ups of infection in the future remain. Therefore, traditional revenue sources will likely be disrupted for a long time. Municipalities are currently constrained in their ability to increase cash inflows—2020 tax rates have been approved, traditional recreational activities have been closed, and cash related to reserves are usually legally restricted. Outcomes of this analysis should be factored into the scenario planning. Municipalities should, therefore, look for unconventional means to improve their liquidity in the short-term, such as:

Divesting non-essential assets

- Municipalities should consider selling non-essential assets to assist with cash-flow needs, including vacant land, ownership shares in local distribution power companies, or investments in other municipal companies.
- Unconventional instruments, such as sale and lease-back opportunities of parks or roads, may also provide immediate cash inflows to cover operating expenses.

Borrowing to cover financial shortfall

- Many provincial and territorial governments have strict rules regarding the ability of their municipalities to run a deficit in a particular year and any borrowing required to cover this deficit. Most municipal acts do allow deficits to be funded by operations within the following budget year as well as short-term borrowing, up to a prescribed limit, to cover the financial shortfalls. Each municipality should refer to its applicable act and announcements from its minister when investigating the possibility of borrowing to cover its financial shortfall.
- Constraints on municipalities are evolving in light of the crisis. On April 28, 2020, for example, the Province of Nova Scotia launched a loan program. Municipal governments there are now able to apply for immediate cash assistance in the form of a loan, with repayment terms over three years, to help them with financial losses due to COVID-19.³ Similar announcements could be made by other provinces and territories in the near future.
- Regardless of the source and size of a loan, each municipality needs to ensure it has a repayment plan included in its future cash-flow forecast.



Success factors

To ensure the success and sustainability of the COVID-19 response measures, we advise considering the following:

Ensure appropriate communication with councils

Tough decisions will be required. To drive alignment and maintain the trust of key stakeholders and municipal councils, it will be imperative to gather an accurate view of the cash-flow position and forecast, and equally as important to communicate it adequately. This means clearly laying out the data, timelines, assumptions, and sources of information, and visually representing the outcomes so that timely, informed decisions can be taken and their impact on each community clearly understood.

Engage citizens and build community

Municipalities are facing a wide variety of public pressures as they navigate how to respond to this pandemic. Citizen engagement during these changes is critical. Being clear and transparent with citizens, and communicating frequently to understand and manage expectations, will be vital.

- As the municipality discusses the changes at council, citizens need to understand: What could be changing?
- What impact does a change in services have on the financial outlook of the municipality?
- What would happen if these changes were not implemented?

Although economics are driving the need to make difficult decisions, municipalities should do what they can to align these required changes to their existing vision. This will help maintain a sense of community during these difficult times.

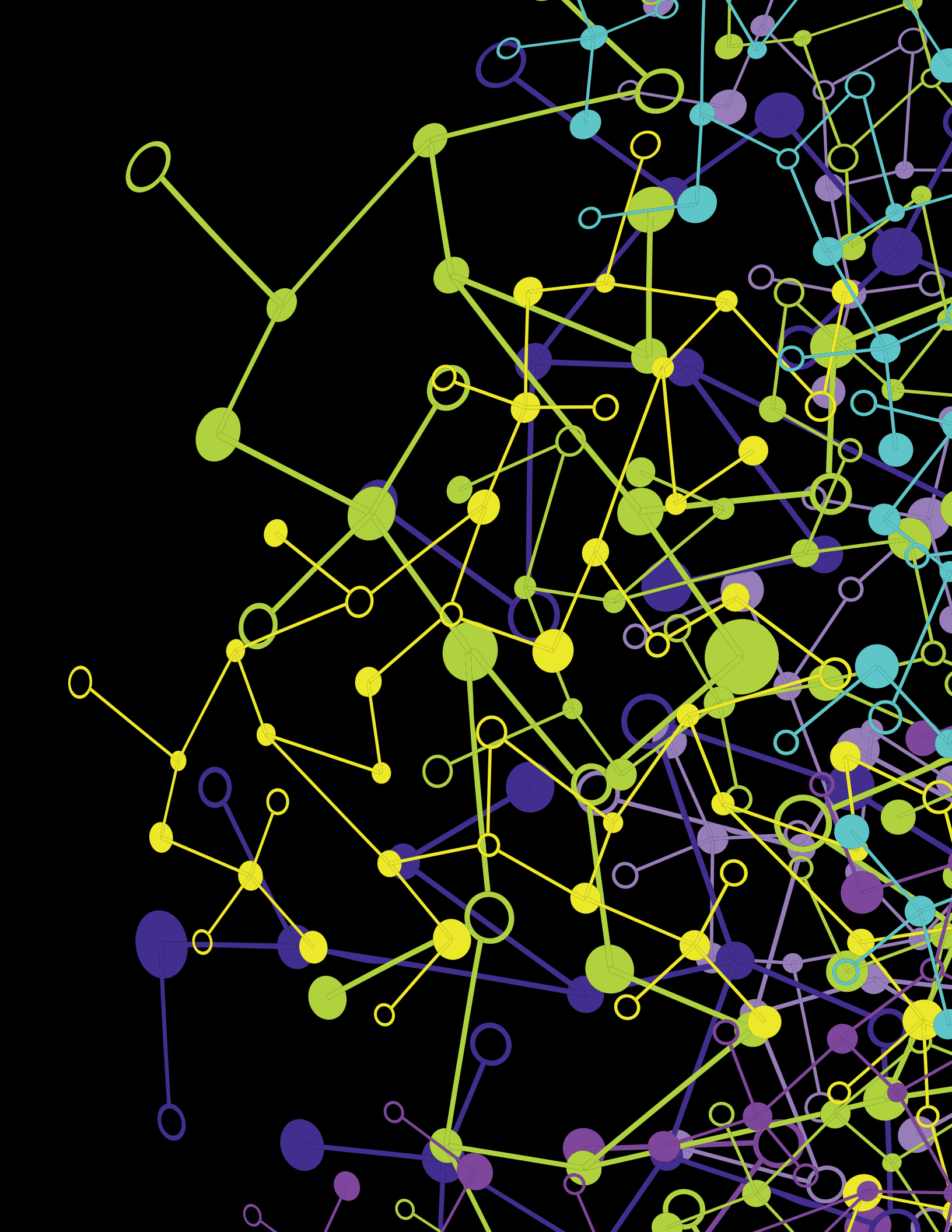
Position strategically for recovery

The respond phase is temporary. If municipalities ensure their response-phase processes and systems are nimble, these can be quickly de-activated once recovery signs begin to take hold. To best position for the recover and thrive phases, municipal leaders will likely find that keeping a log of operational changes as well as monitoring outputs and outcomes can prepare their communities for a successful recovery. Lessons learned under the new ways of working may provide continued operating efficiencies in the future.

Look out for our next publication where we will examine the second step in managing the COVID-19 crisis: recovery. In it, we will explore how municipal leaders can build on the hard work and lessons learned during their immediate response and chart a course to recovery.

For more coverage on navigating the COVID-19 pandemic, visit the Deloitte portal.

³ <https://novascotia.ca/news/release/?id=20200428004>





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