Financial Sustainability

Presentation to Regional Council

Bill Hughes, Commissioner of Finance & Regional Treasurer

April 20, 2017

Overview

- Financial sustainability
- The need for additional revenue
- The fiscal gap: tax levy pressures
- The fiscal gap: the debt challenge
- Increasing revenue
- Conclusion

Financial Sustainability

Financial sustainability means…

- Growth can be accommodated without unacceptable tax levy or debt increases
- Infrastructure can be kept in a state of good repair and replaced at the right time
- Service levels can be increased as the Region urbanizes
- Service levels can be maintained in the face of changes in economic conditions
- Financial responsibility is fairly shared between current and future residents (inter-generational equity)

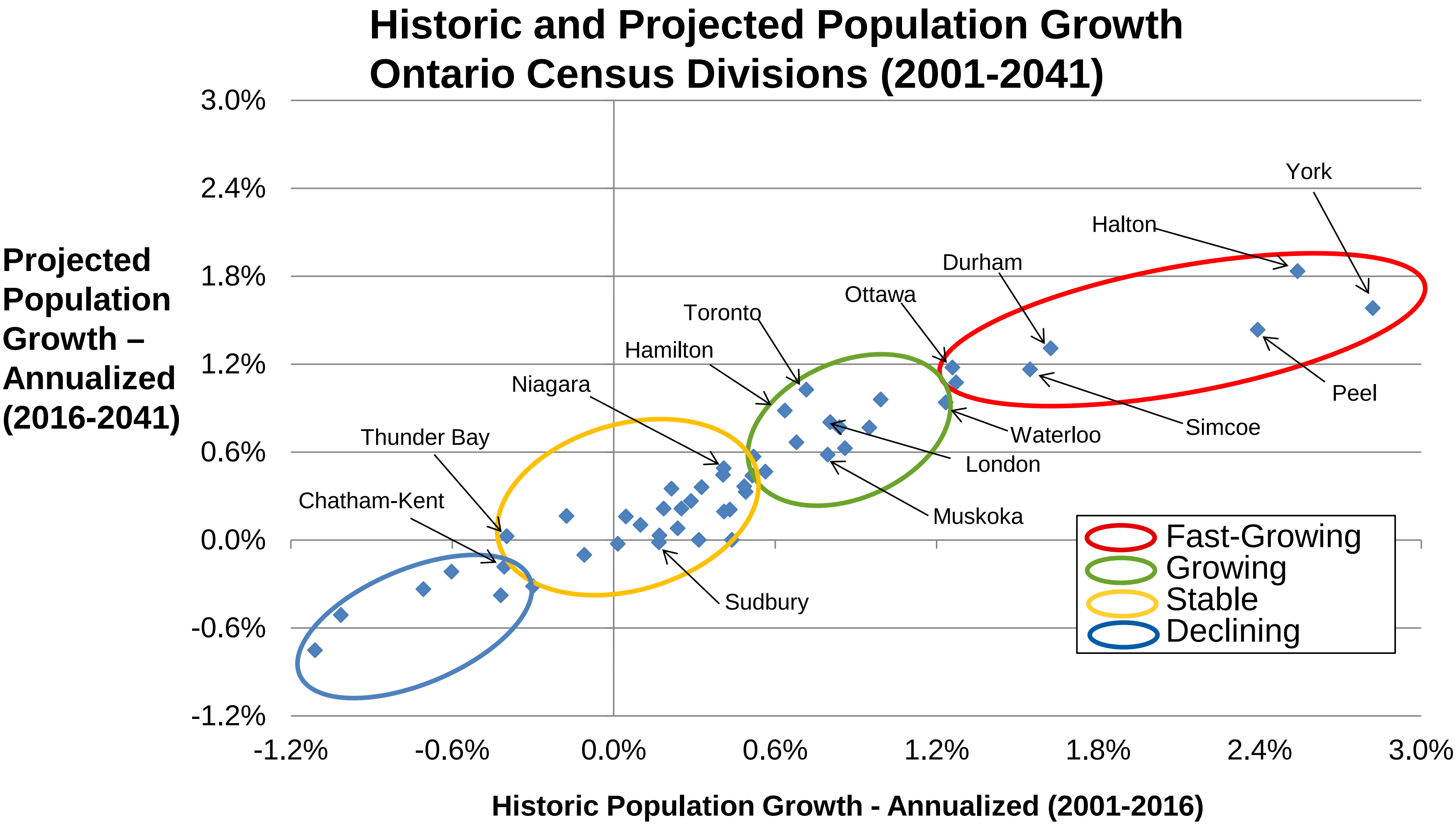
Financial sustainability is about the stewardship of the long-term

- Financial sustainability requires long-term planning; it does not just happen

- The key to financial sustainability is taking the necessary steps now to manage both short and long-term risks

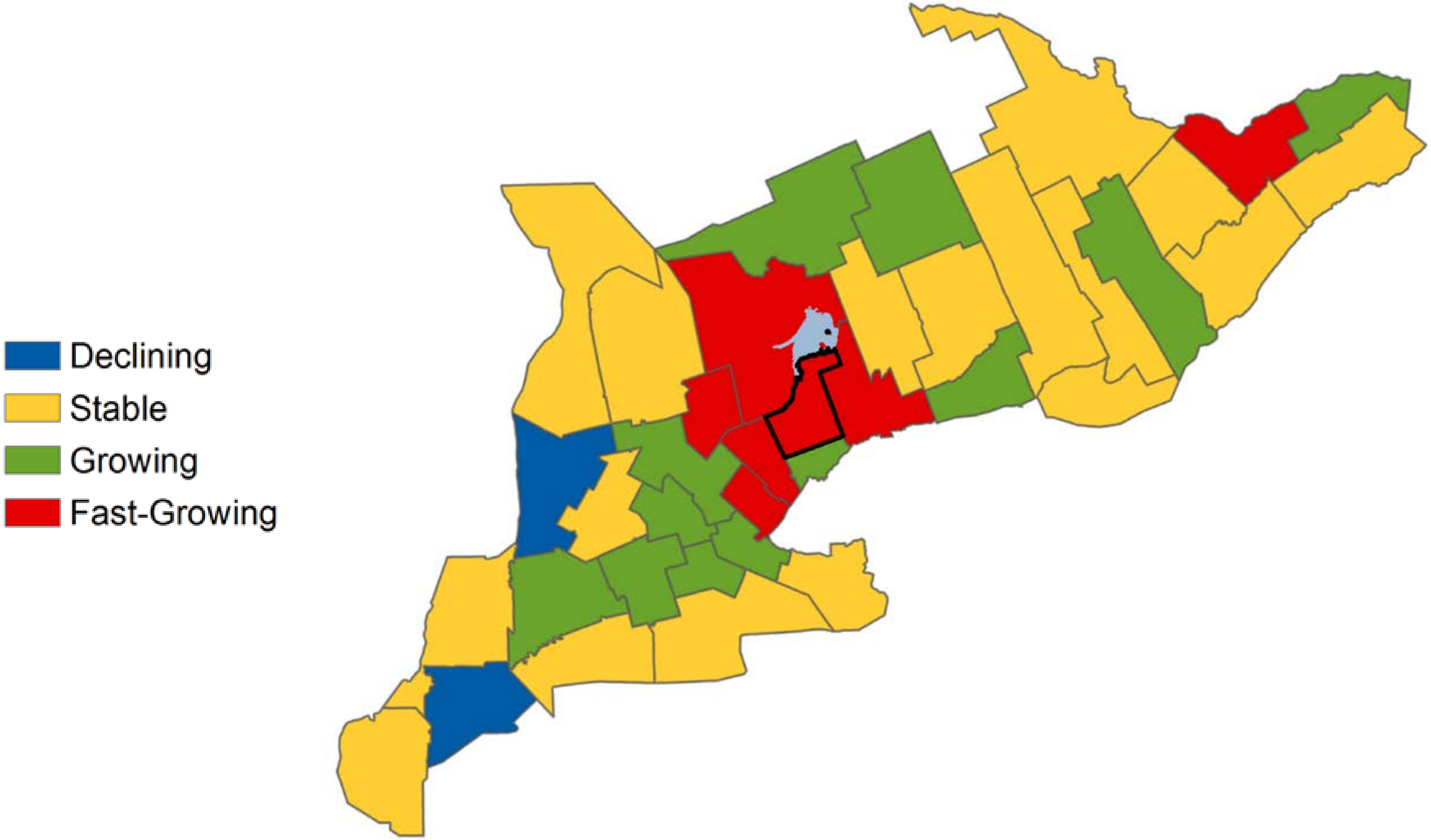
- This is mostly about managing two things: service levels and infrastructure

Past is future: growing municipalities tend to keep growing



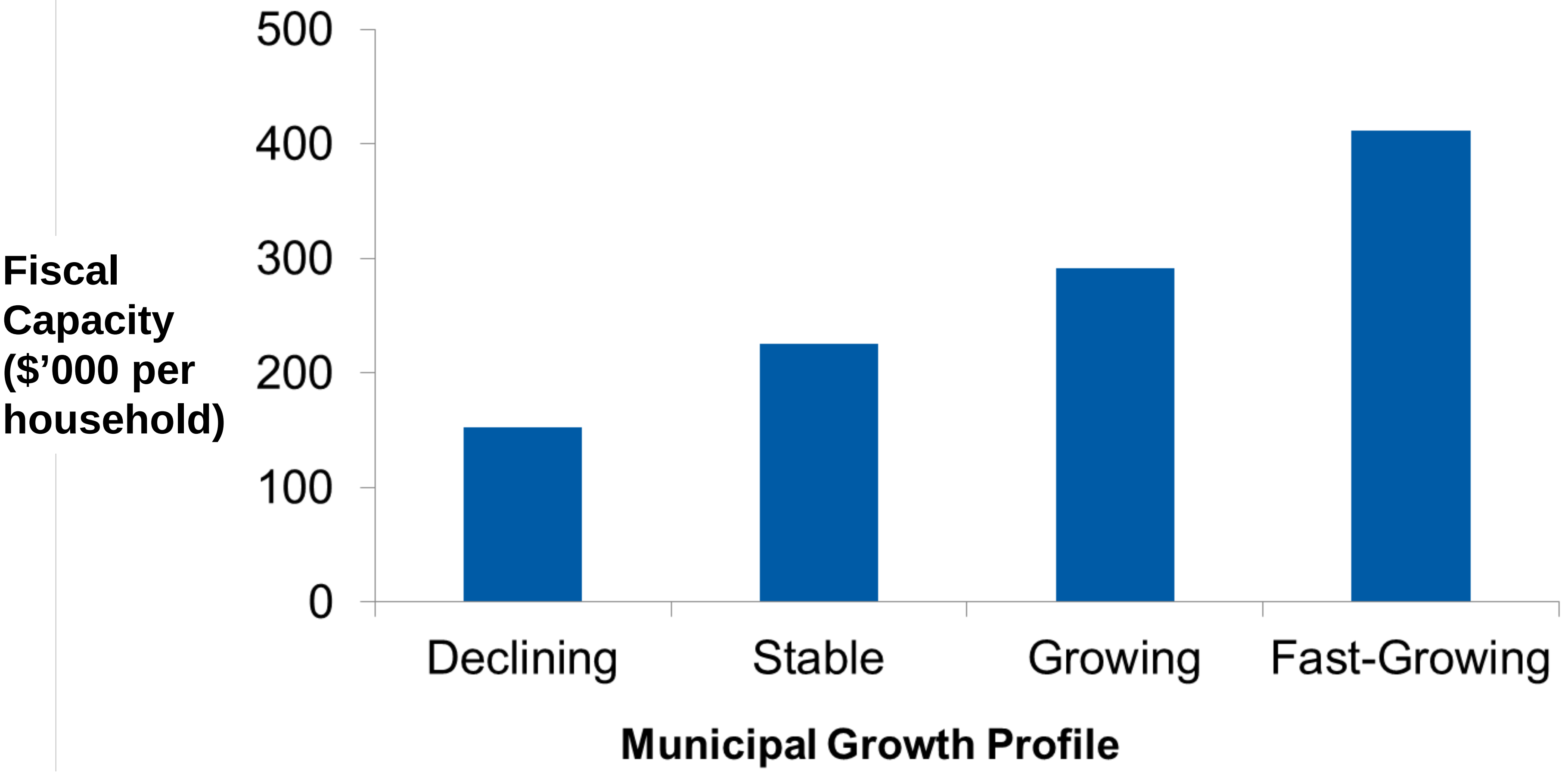
Sources: Projected population growth from Ontario Ministry of Finance; Historic population growth from Statistics Canada

Population growth in Southern Ontario (2001-2041)



Source: Ontario Ministry of Finance, Spring 2016 Population Projections Update

Growing municipalities tend to have more fiscal capacity

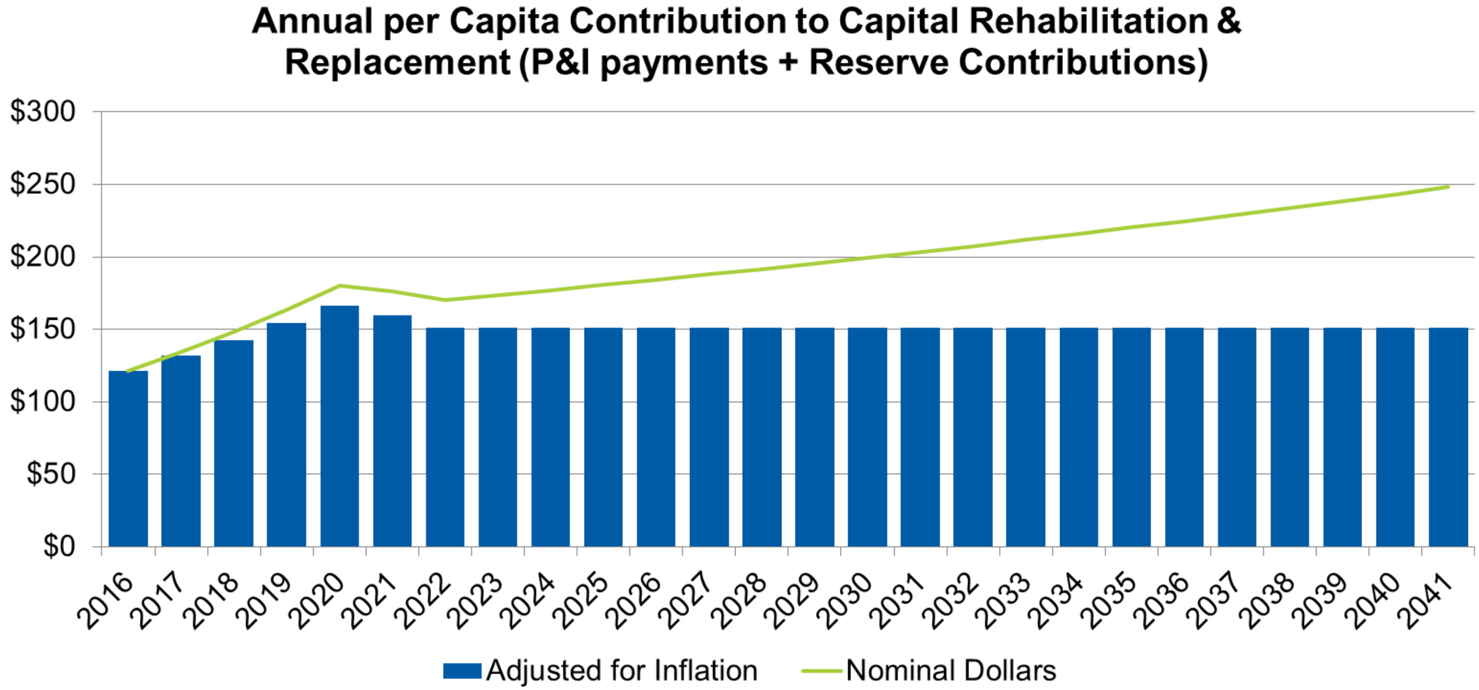


Sources: Fiscal capacity = Weighted average assessment per household, 2013, FIR; Household, 2013, MPAC; population, 2009-2013, Ontario Ministry of Finance

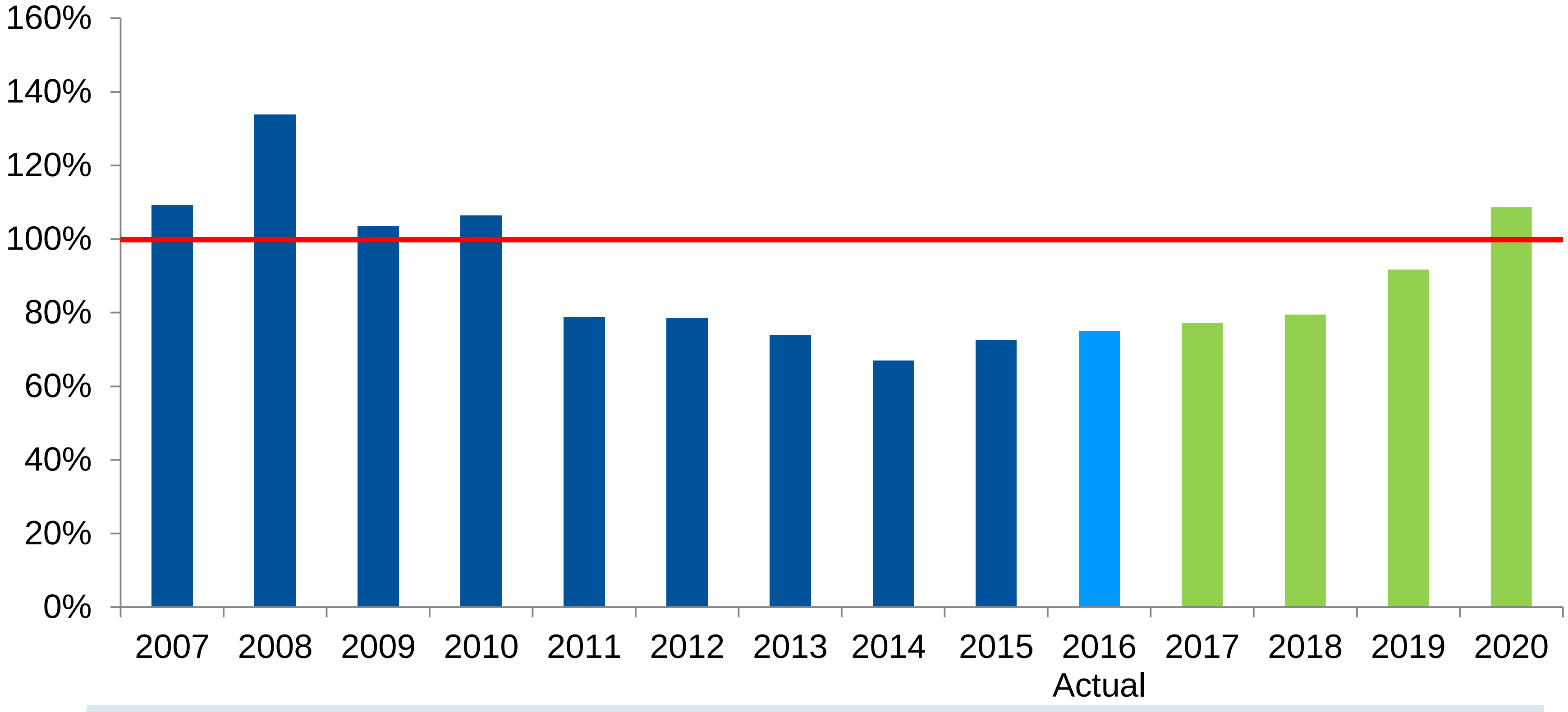
Council has approved two major initiatives that will contribute to long-term financial sustainability

The Region will achieve full cost recovery for water and wastewater by 2021

- Council approved a Financial Sustainability Plan for water and wastewater in 2015
- The plan achieves both full cost recovery and inter-generational equity



The Region should become a net investor by 2020



The reserve to debt ratio is forecast to increase in 2017 and exceed 100% by 2020

Council has identified two broad fiscal objectives

Annual tax levy increases of 3% or less

A reduction in debt

The Need for Additional Revenue

So why is more revenue needed to achieve financial sustainability?

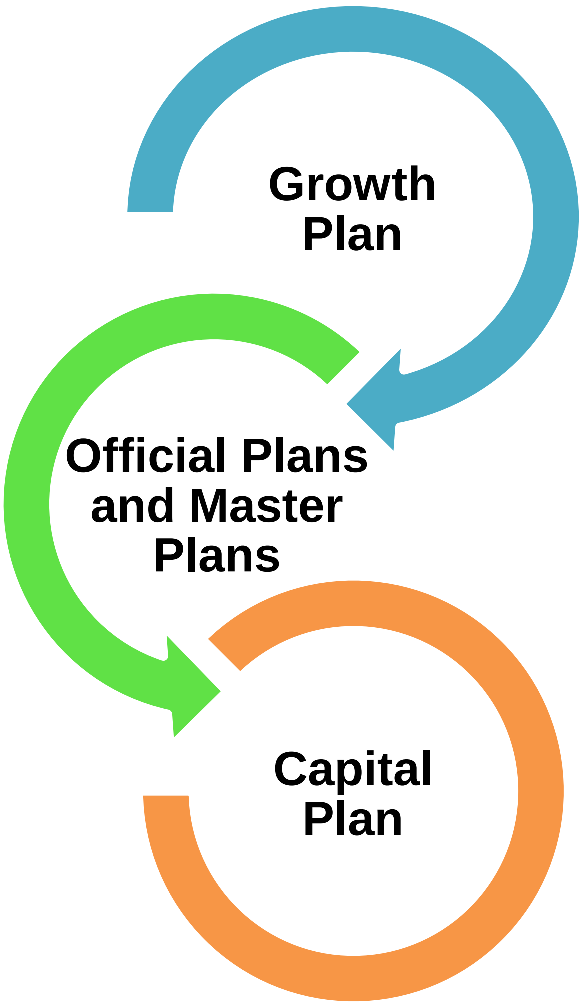
Two big challenges facing the Region

1. A potential disconnect between actual growth and Growth Plan targets

2. The future cost of asset management for a large and aging asset base

The Growth Plan Disconnect

Infrastructure is being built for the Growth Plan population



Mandates growth targets

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Official Plans must conform to the Growth Plan

Infrastructure master plans fall in line

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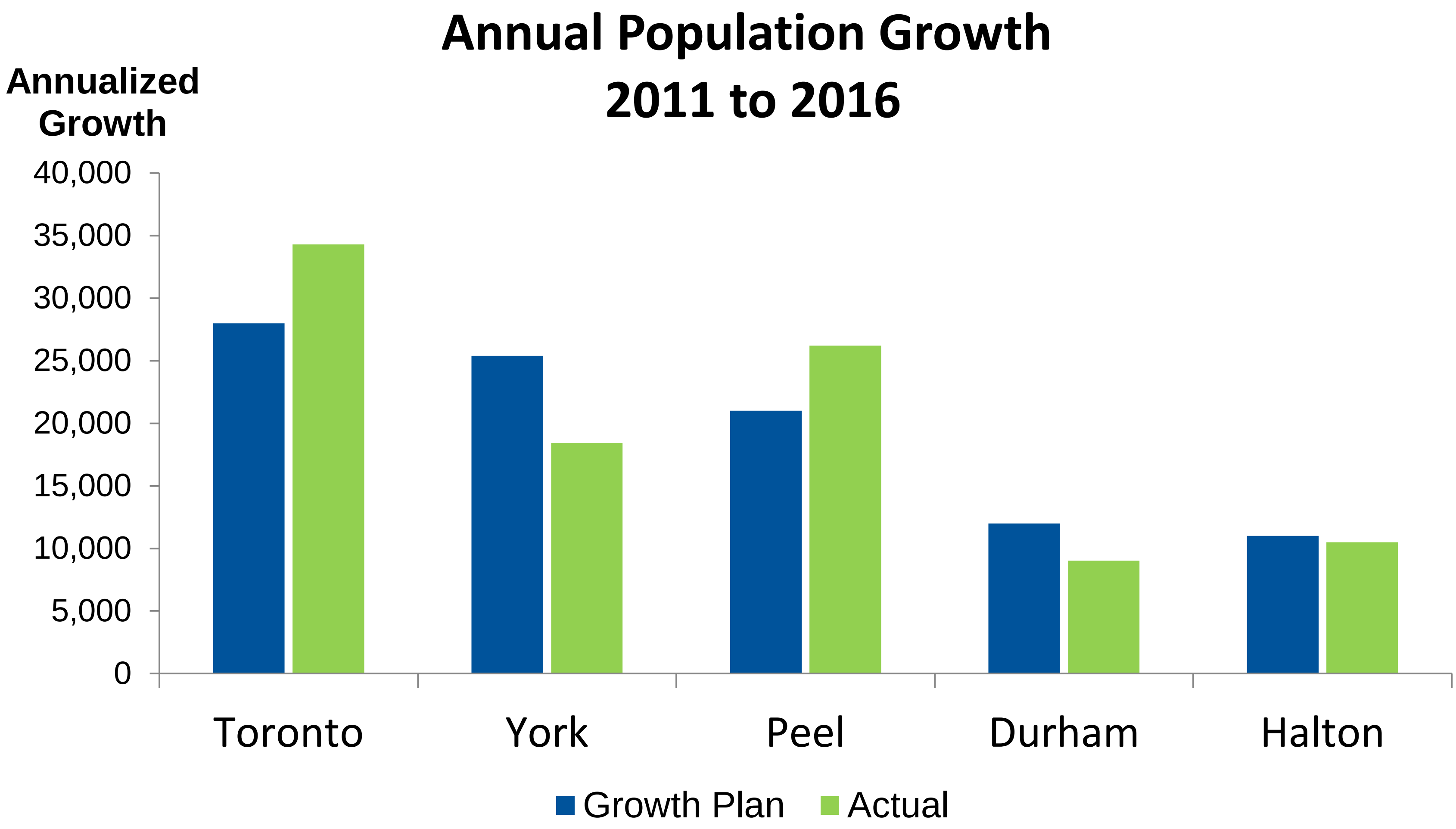
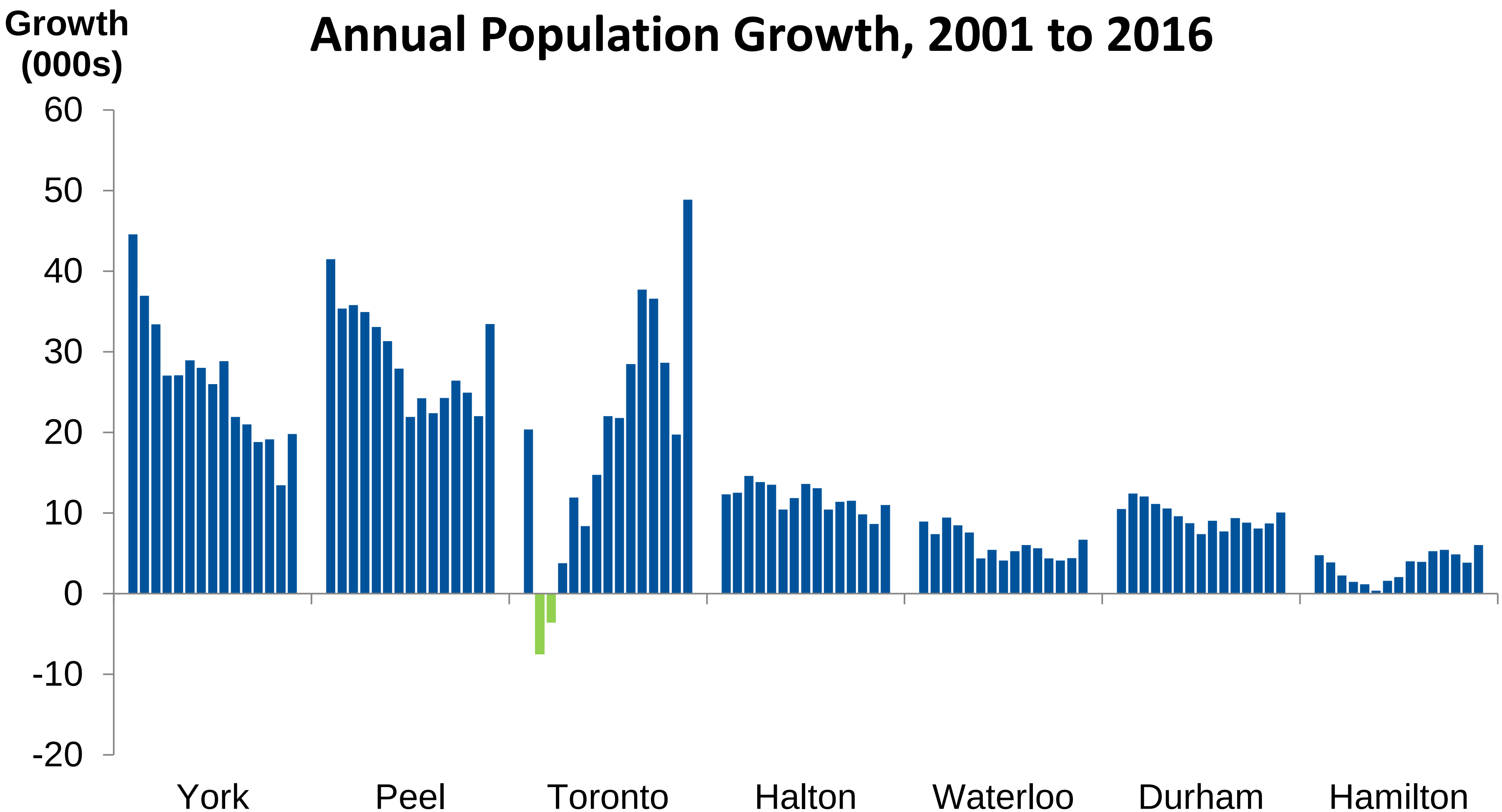
Implements the Master Plans

Population growth in the 905 regions has been slower than expected



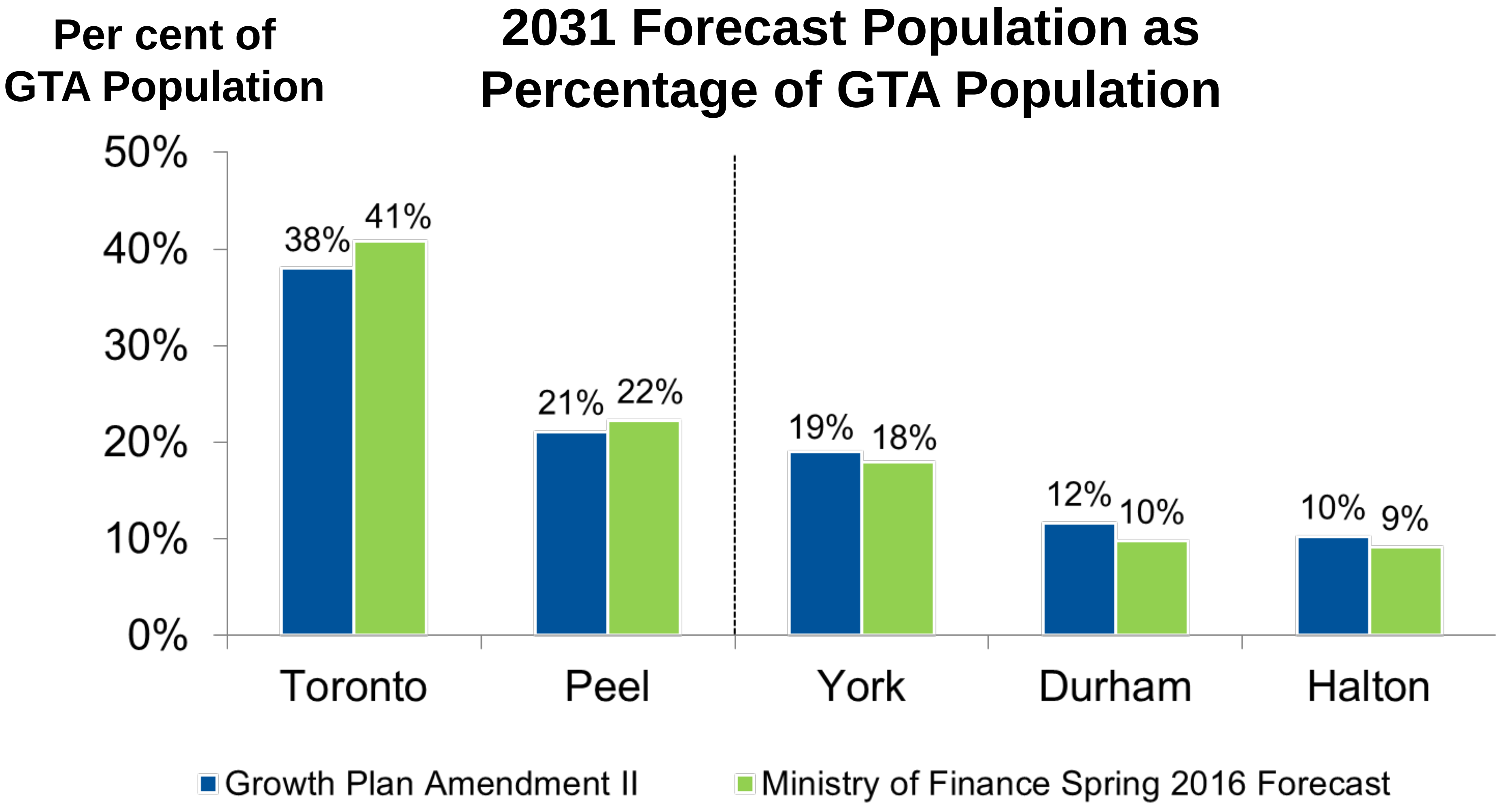
Source: 2006 Provincial Growth Plan, CANSIM 061-0062

Toronto is capturing a higher than expected share of growth



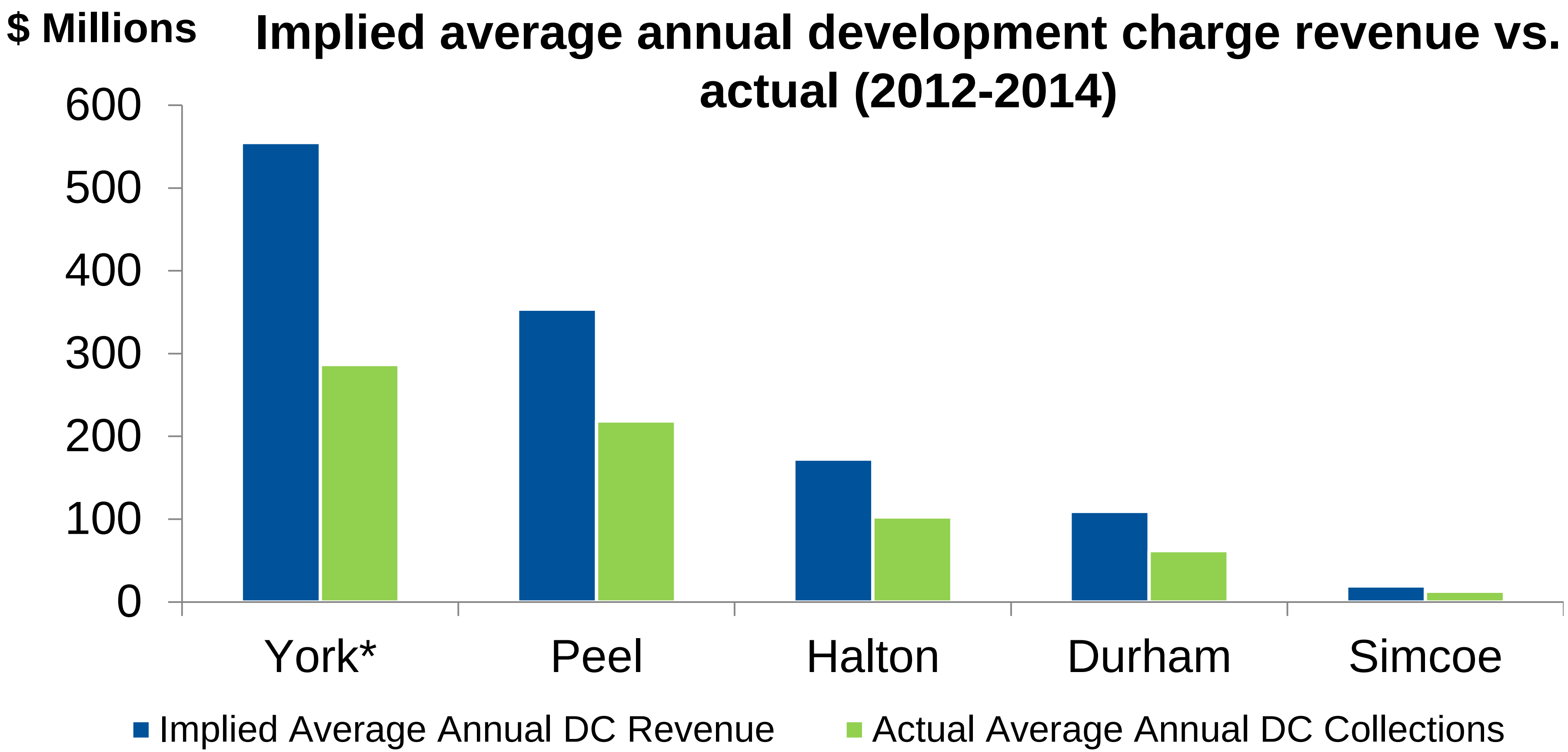
Source: Statistics Canada

The future looks mostly like the past



Source: Growth Plan, Ministry of Finance Spring 2016 Demographic Outlook

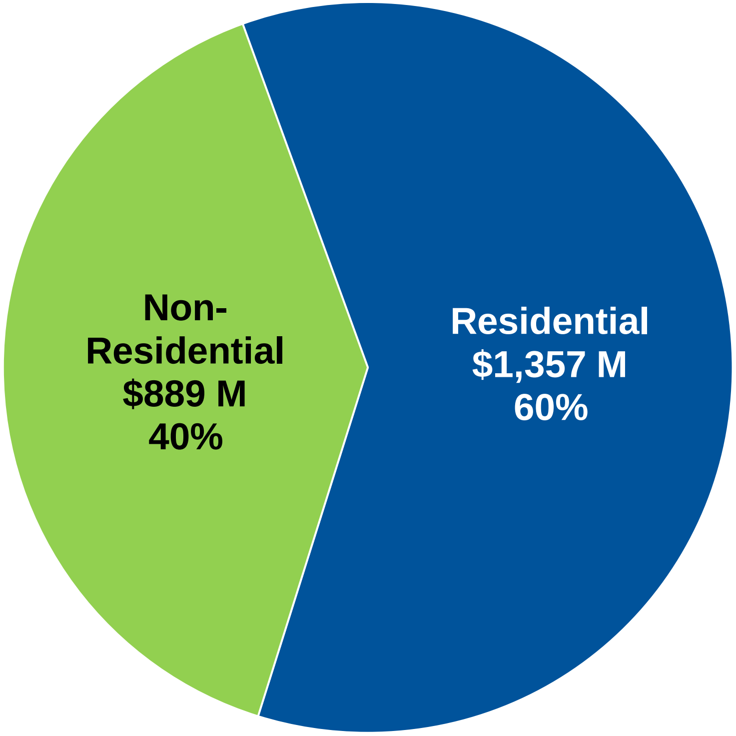
Slower than expected growth means lower than expected development charges



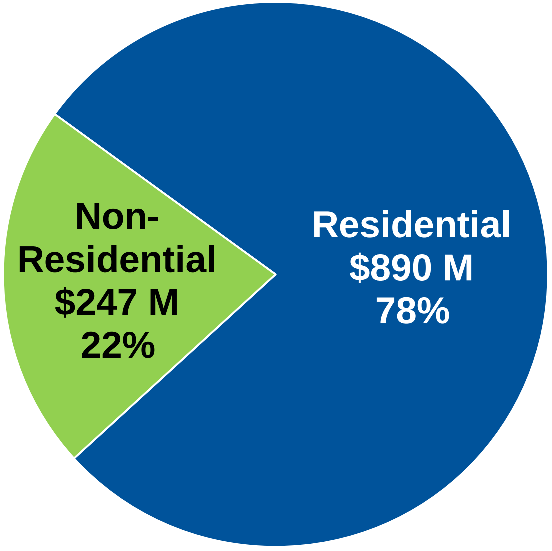
Note: Compared to the last background study
*York Region's average annual expected development charge revenue is based on the 2012 development charge background study implied collections of $555 million per year.
Source: York Region Office of the Budget

Development charge collections have been well below expectations in York Region

Implied DC Collections*:
mid 2012 to mid 2016
$2.2 Billion



Actual DC collections:
mid 2012 to mid 2016
$1.1 Billion



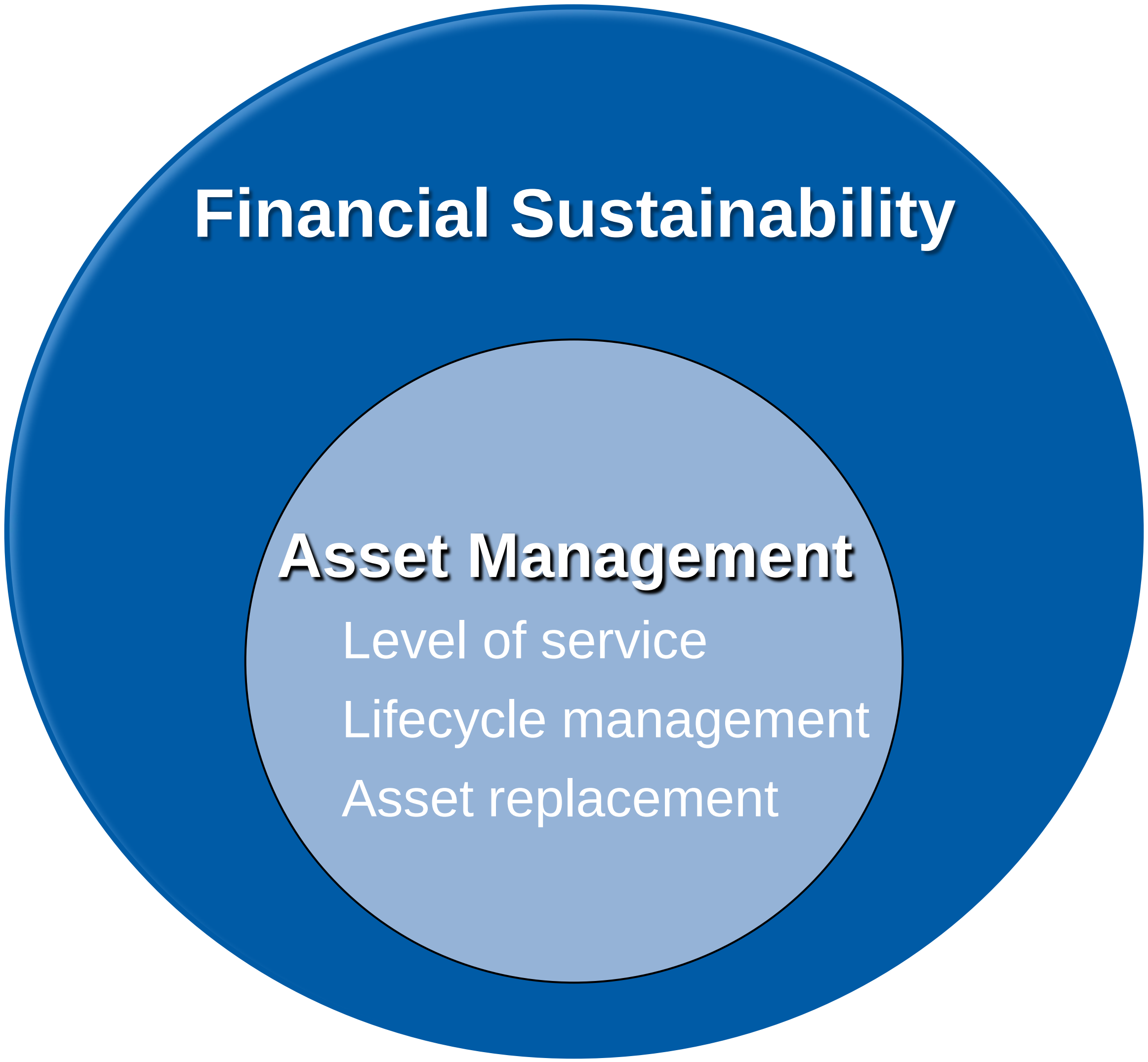
*Gross collections based on 2012 development charge background study
Source: 2012 DC Background Study, York Region Treasury Office

Key points

- Toronto is capturing a larger than expected share of growth in the GTA, and this trend will likely continue
- Because municipalities are required to conform to the Growth Plan, the 905 regions (and possibly others) may be over-investing in capital
- If growth and development charges remain below expectations, there is a risk of stranded debt and/or stranded infrastructure, which could necessitate capital deferrals

Asset Management

You can't have sustainability… without good asset management

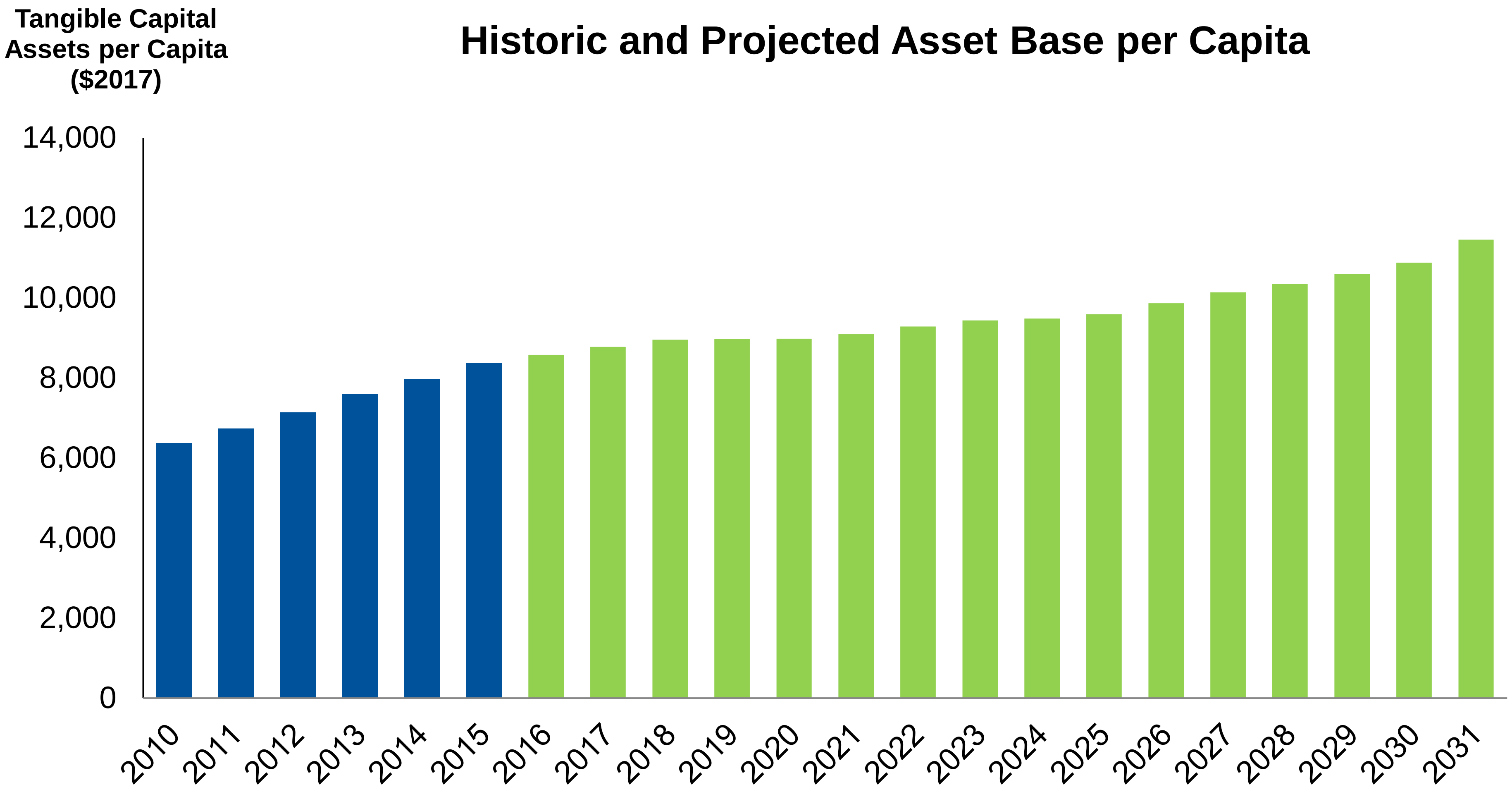


In the last half century, there has been a dramatic shift in responsibility for infrastructure

Share	1961	2014
Federal	28%	15%
Provincial	36%	26%
Local	**36%**	**59%**

Sources: StatsCan, CANSIM Table 031-0005: *Flows and stocks of fixed non-residential capital, by industry and asset, Canada, provinces and territories, annual.*

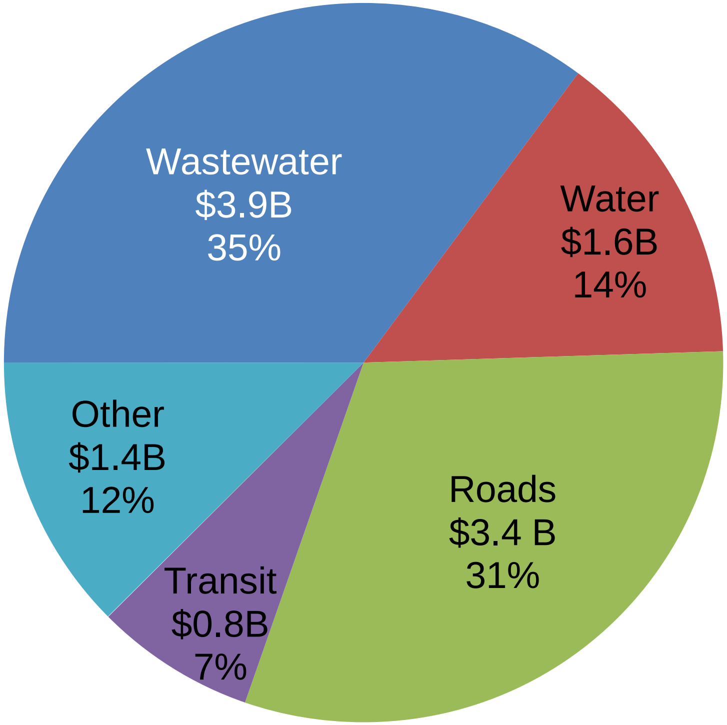
The Region's infrastructure is growing much faster than its population



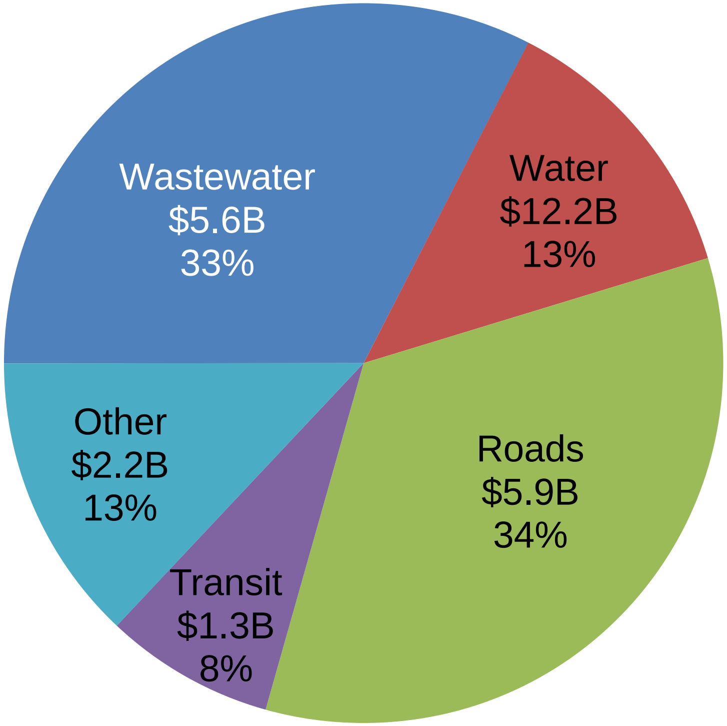
Source: historic population from Statistics Canada; projected population from Ministry of Finance Spring 2016 Population Projections; historic asset base from York Region Annual Statements; and, projected asset base from 2017 Budget amended with draft 2017 development charges background study

York Region's infrastructure base is expected to continue growing quickly

Replacement Cost in 2015 based on 2015 State of Infrastructure Report ($11 Billion*)

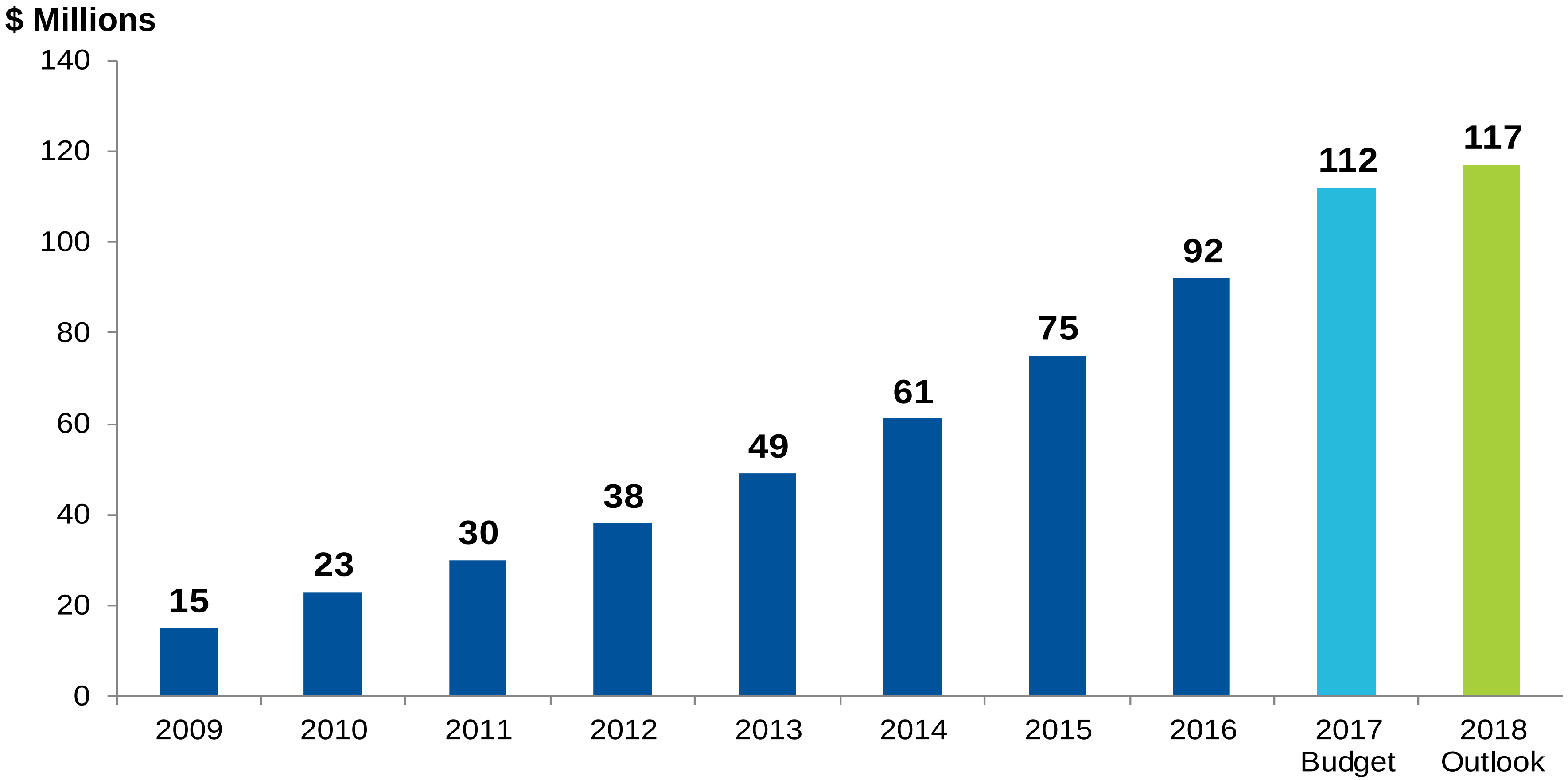


Projected Replacement Cost in 2031 based on Draft 2017 DC Background Study ($17.2 Billion)



*Land not included

Asset replacement reserves will need to continue to grow



In 2013, Council approved incremental increases to capital asset replacement reserve contributions to achieve a 2% increase in 2017

Key points

- Municipalities are responsible for a much bigger slice of the infrastructure pie than in the past
- Sound asset management will become increasingly important as the Region’s infrastructure base grows and existing assets age
- Increased investment in asset management will be required

The Fiscal Gap Part 1:
Tax Levy Pressures

What is the fiscal gap?

- The tax levy portion of the fiscal gap is desired spending that cannot be accommodated within a 3% tax levy increase, other things being equal

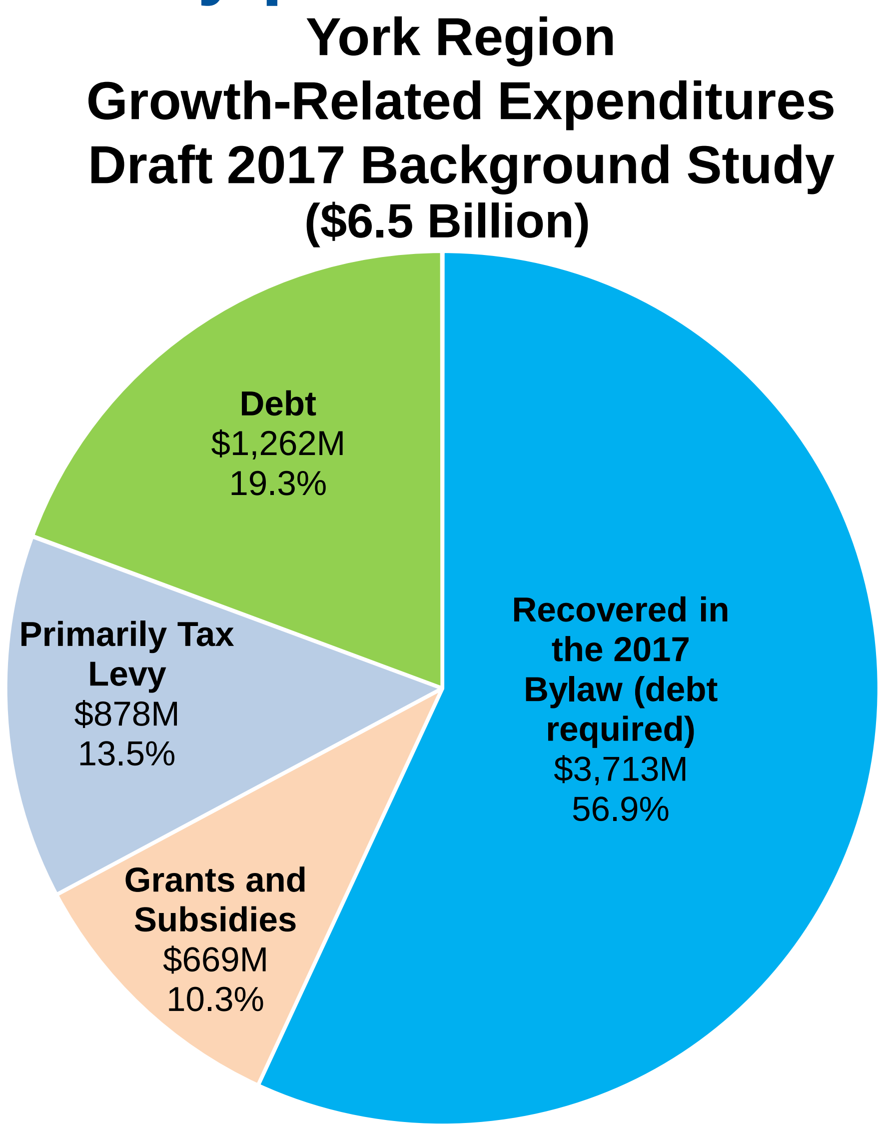
What makes up the fiscal gap?

1. Costs for growth-related infrastructure that cannot be recovered through development charges

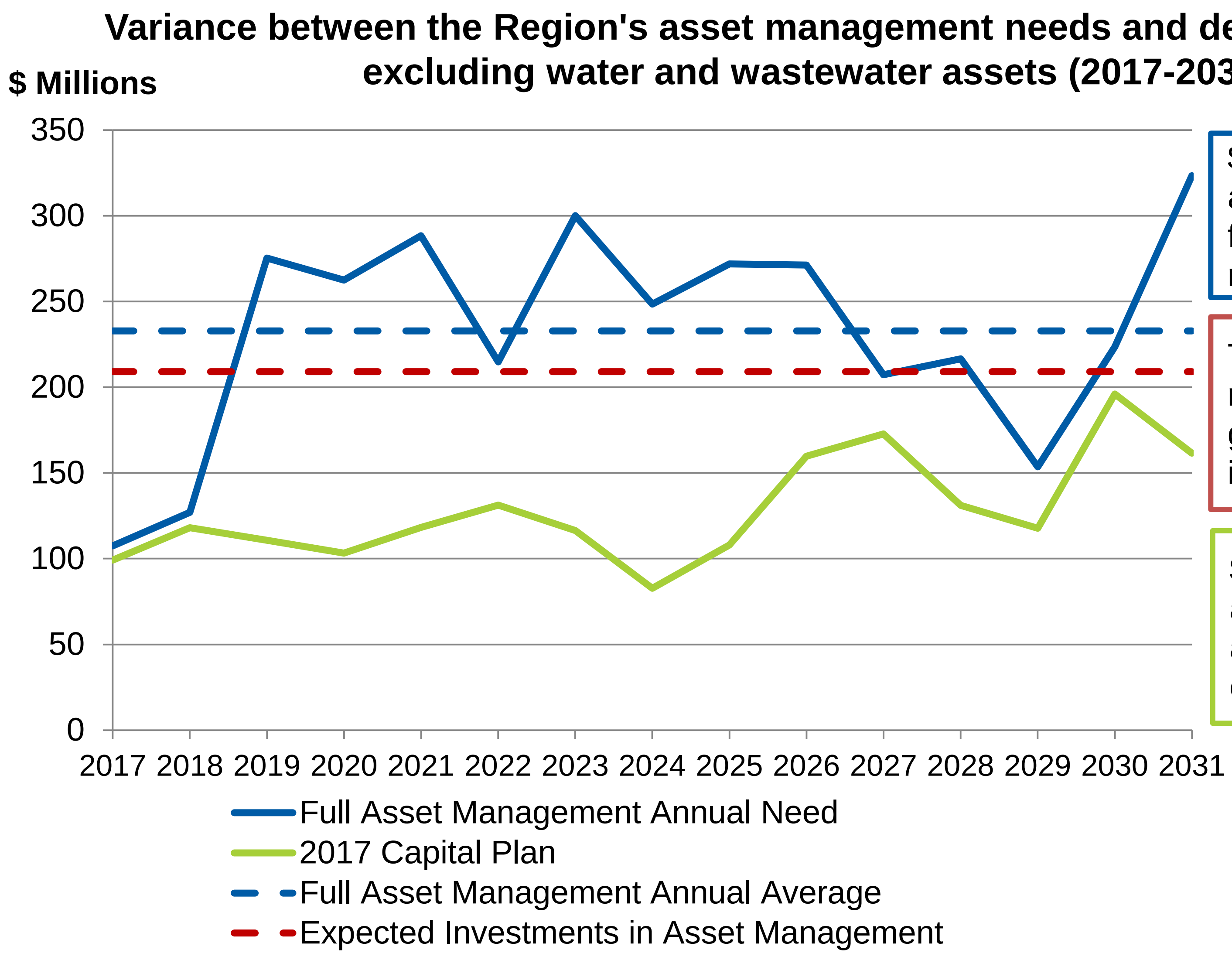
2. Asset management costs that cannot be accommodated within the current ten-year capital plan

3. The Region's share of federal-provincial-municipal mega-projects

The inadequacy of development charges creates a tax levy pressure



The Region will need an additional $24 million annually to maintain a good state of repair for non-water & wastewater assets



$233 million per year on average will be required to fully fund asset management activities

There is a projected $24 million average annual gap in asset management investments

$128 million per year on average is allocated to asset management in the current capital plan

It is possible that the Region will be expected to contribute to cost-shared mega-projects

- The Region's share of the Yonge subway is assumed to be one-third (for illustrative purposes)
- Depending on the assumptions used, 74% to 80% of the Region's costs are assumed to be paid for by development charges, with the remaining 20% to 26% from the tax levy

Additional revenue needed for Yonge subway funding

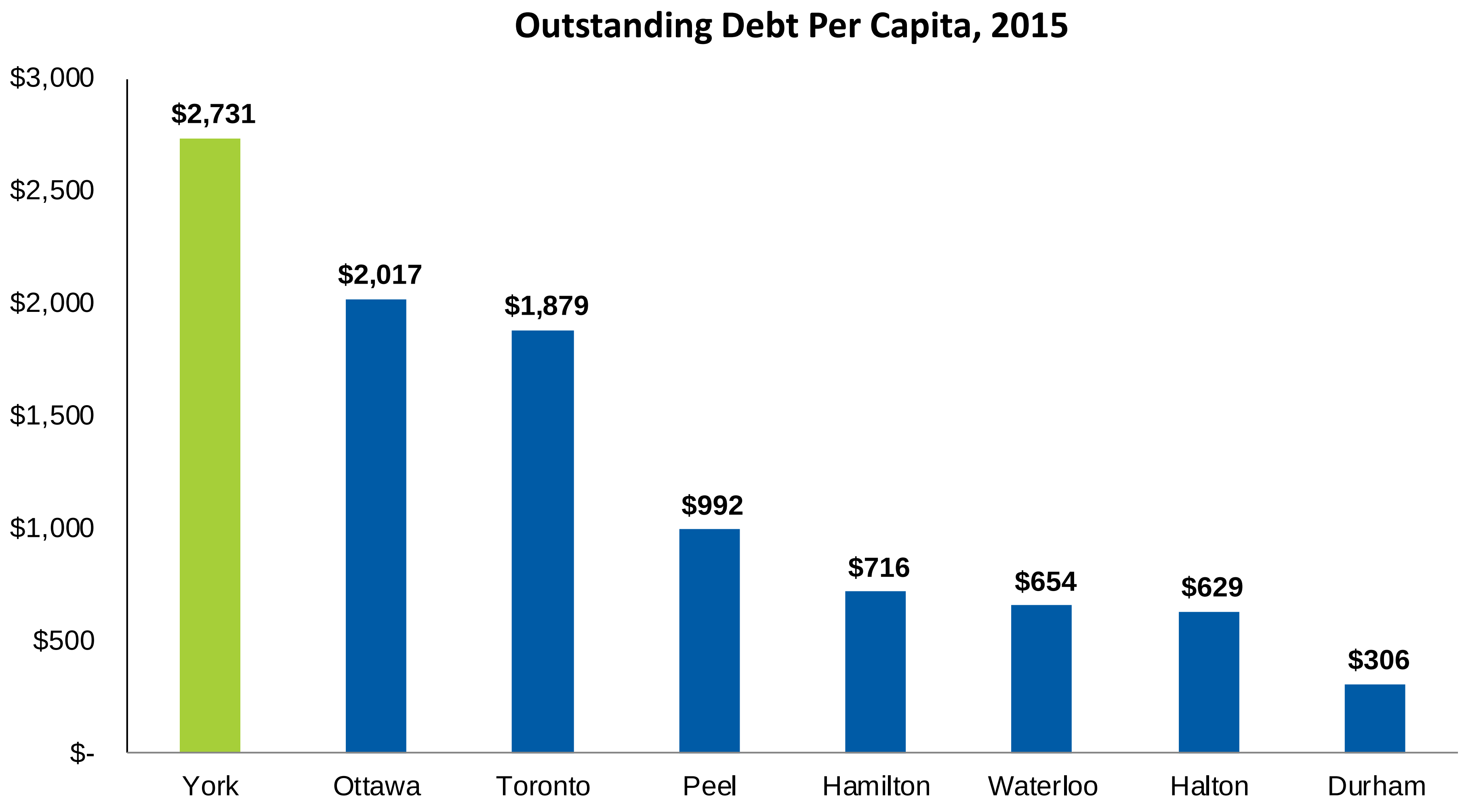
($ millions)	Gross Costs	Region's Share	DC Eligible Costs	Tax Levy
Yonge Subway (portion in York Region)	3,090	1,020	755 to 820	200 to 265

An initial estimate of the fiscal gap is approximately $125 million per year

($ millions)	DC Main List	Contingency List	Yonge Subway	TOTAL
Unfunded Expenses				
Non-DC-eligible costs	57	9	13 to 18	79 to 84
Asset management costs	24	19	-	42
Fiscal Gap	**81**	**28**	**13 to 18**	**122 to 127**

The Fiscal Gap Part 2: Managing Debt

York Region has relatively high levels of debt



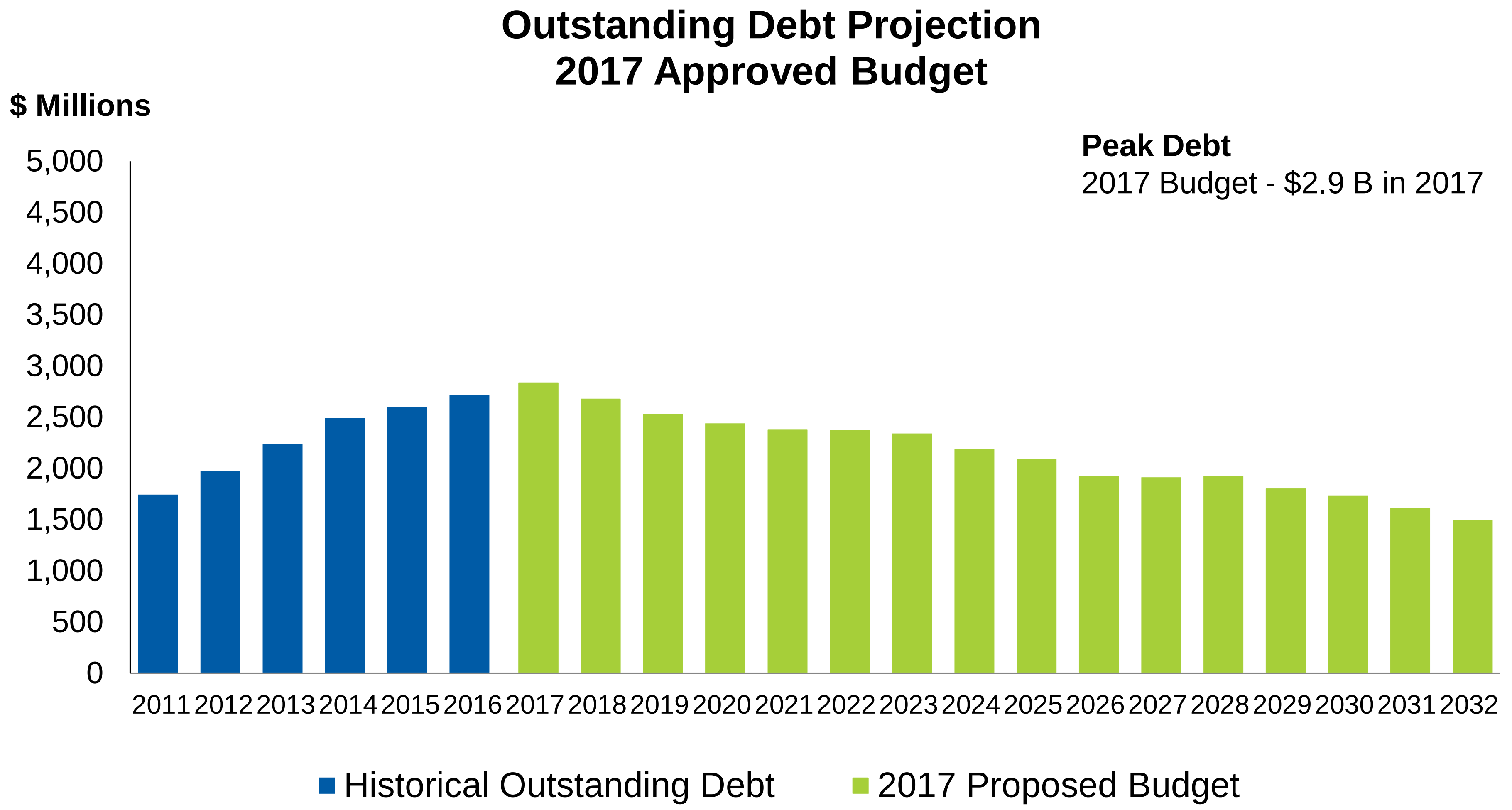
Source: BMA Management Consulting Inc. Municipal Study 2016

Major growth-related capital projects have required significant debt

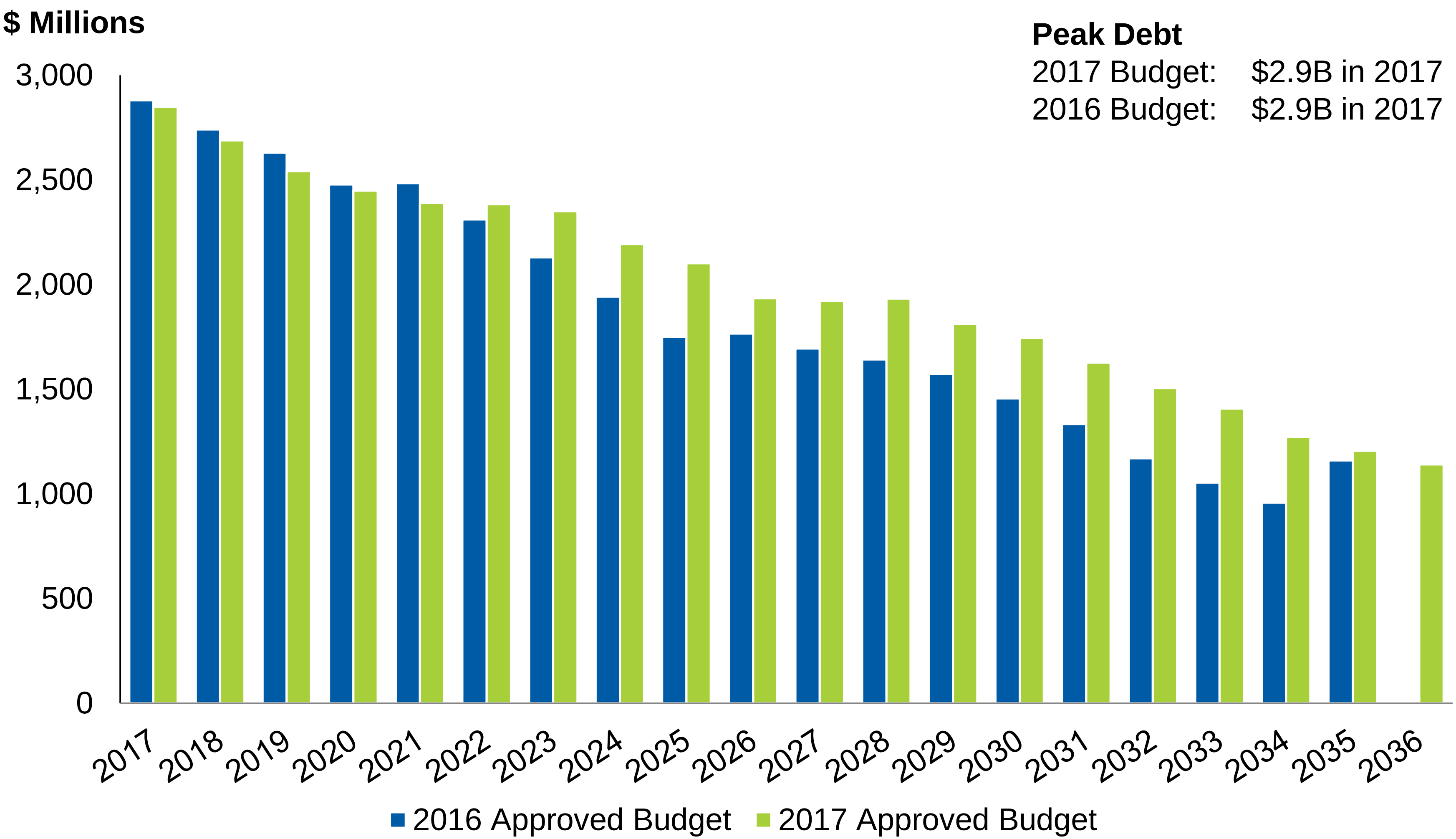
Top Ten Capital Projects Contributing to Outstanding Debt

Project Type	Project Name	Total Budgeted Cost ($ millions)	2016 Debt ($ millions)
Wastewater	YDSS Southeast Collector	572	479
Water	Peel Water Supply Cost Shared Work	582	359
Wastewater	YDSS Duffin Creek Expansion	626	288
Transit	Spadina Subway Expansion	1,329	181
Water	Toronto Water Supply Cost Shared Work	460	172
Wastewater	Duffin Creek Stage 1 & 2 Upgrades and Refurbishment	208	118
Wastewater	Keswick Water Pollution and Control Plant	98	74
Water	Kennedy Water Main	76	63
Water	East Vaughan pumping station	53	50
York Region Police	Investigative and Support Services facility	67	48

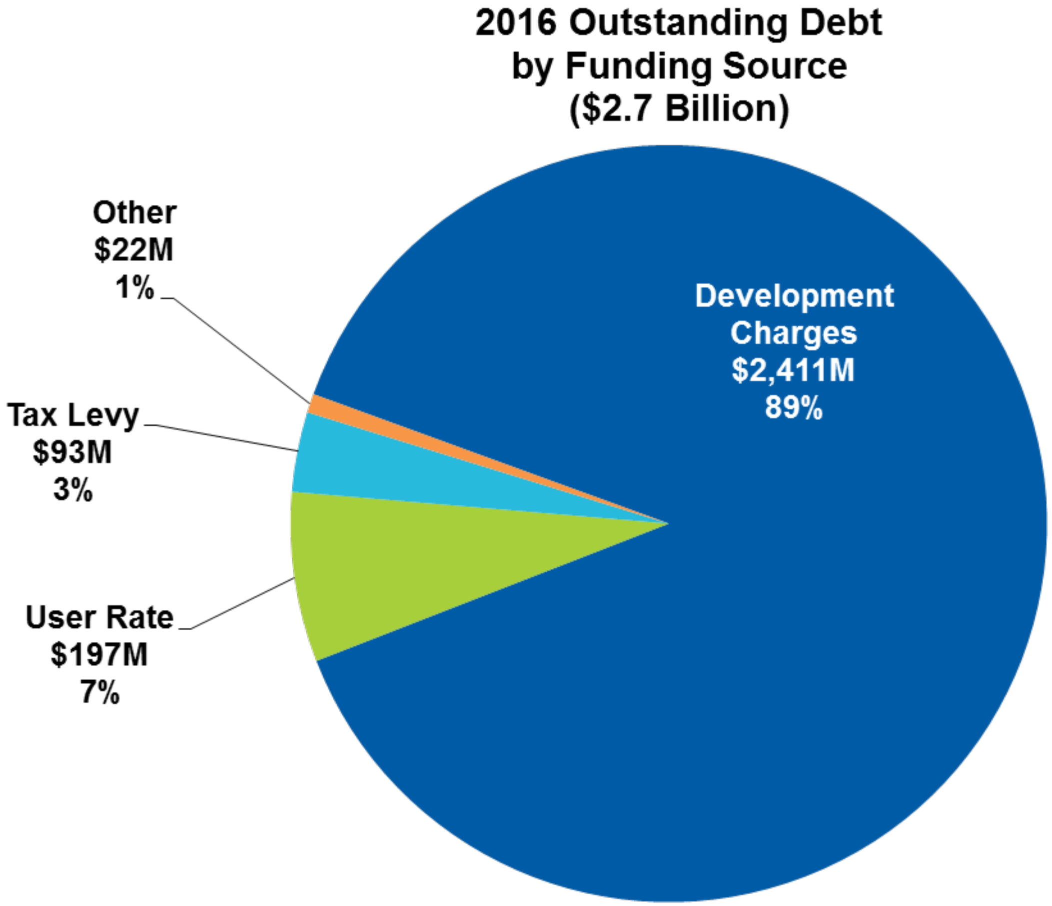
Peak debt will be realized this year



The debt profile deteriorated between 2016 and 2017

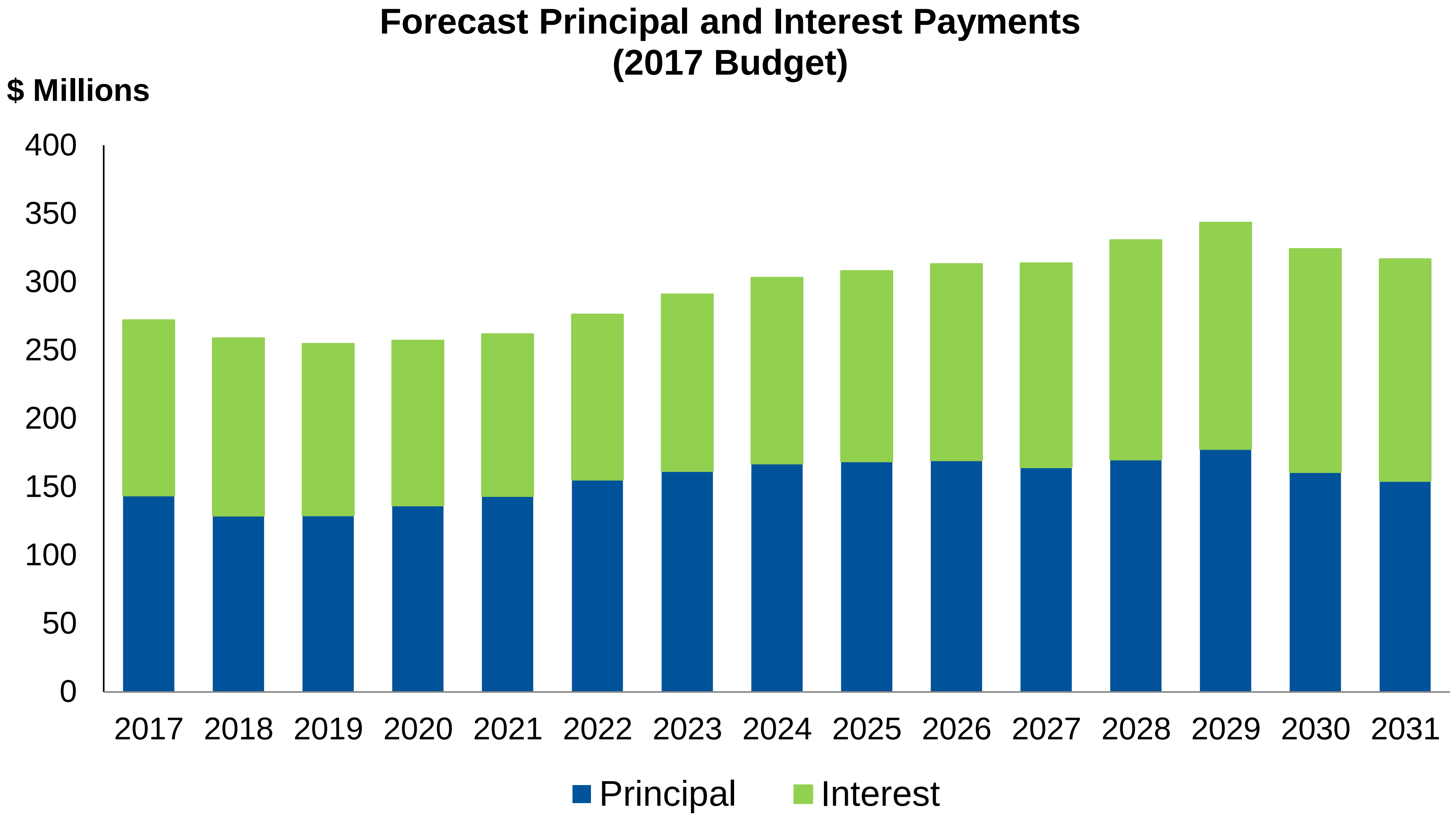


Most of the debt is supported by future development charge revenue

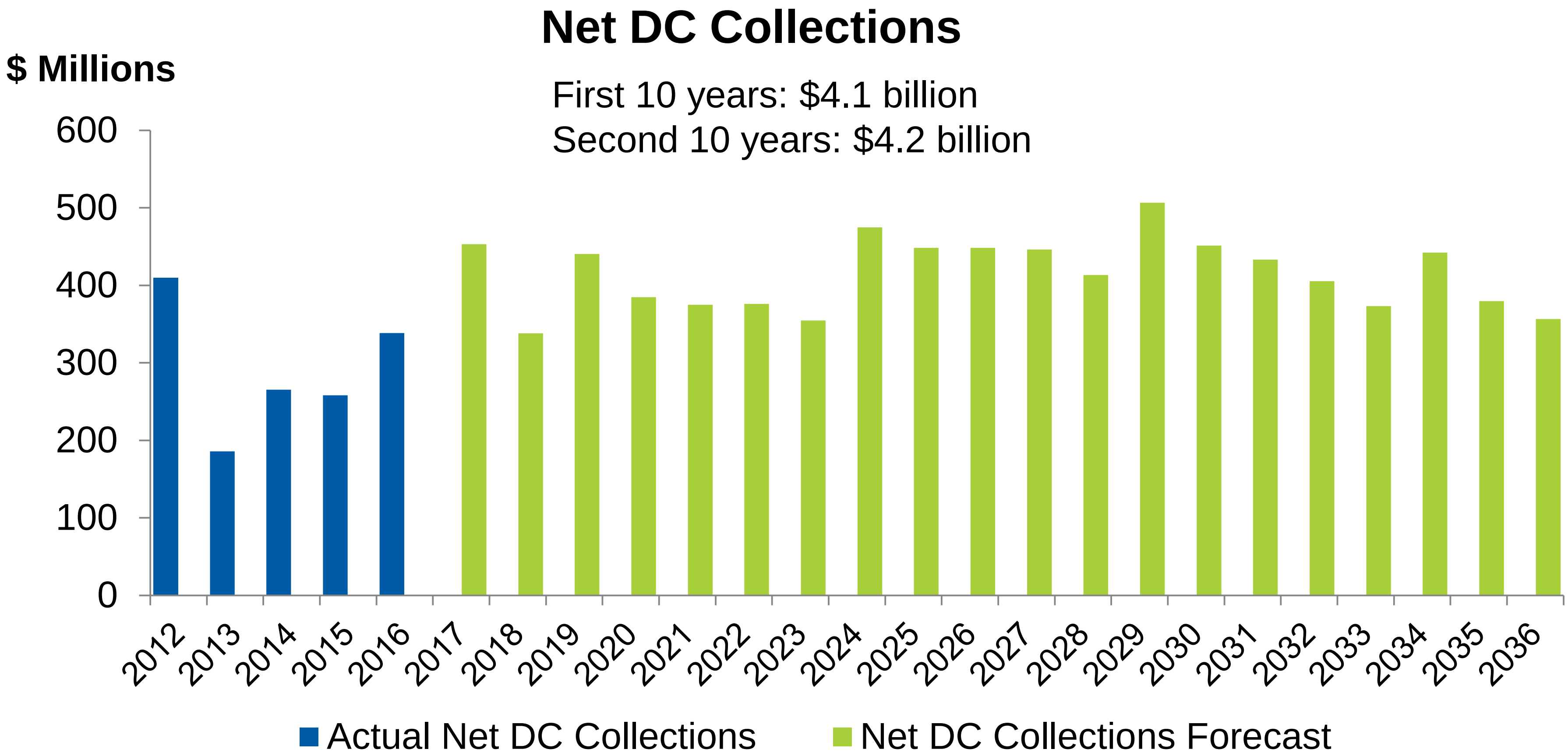


New tax levy and rate supported debt have been eliminated as a result of the fiscal strategy

Debt servicing costs are significant

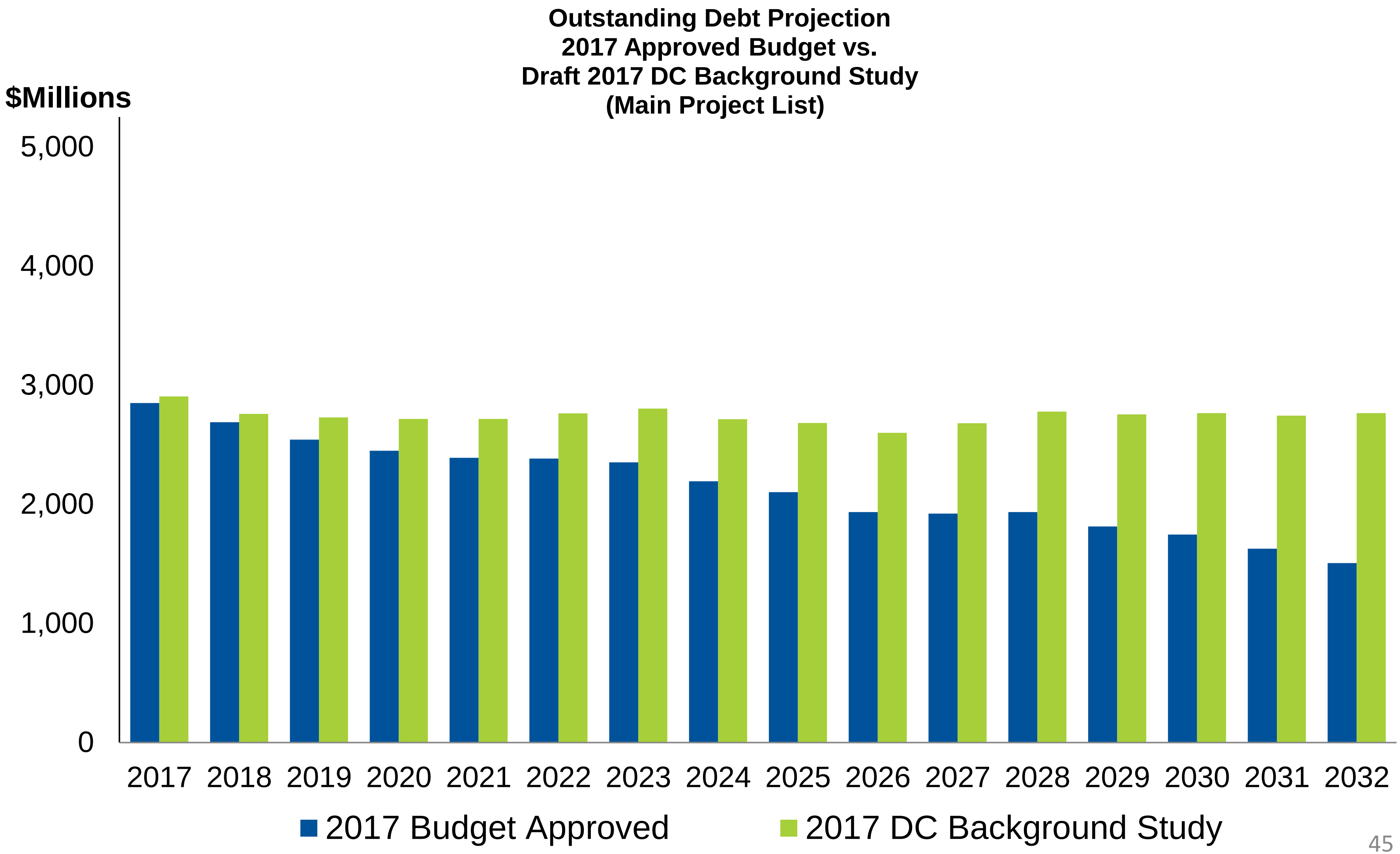


The capital plan and the debt management plan are highly reliant on development charge collections

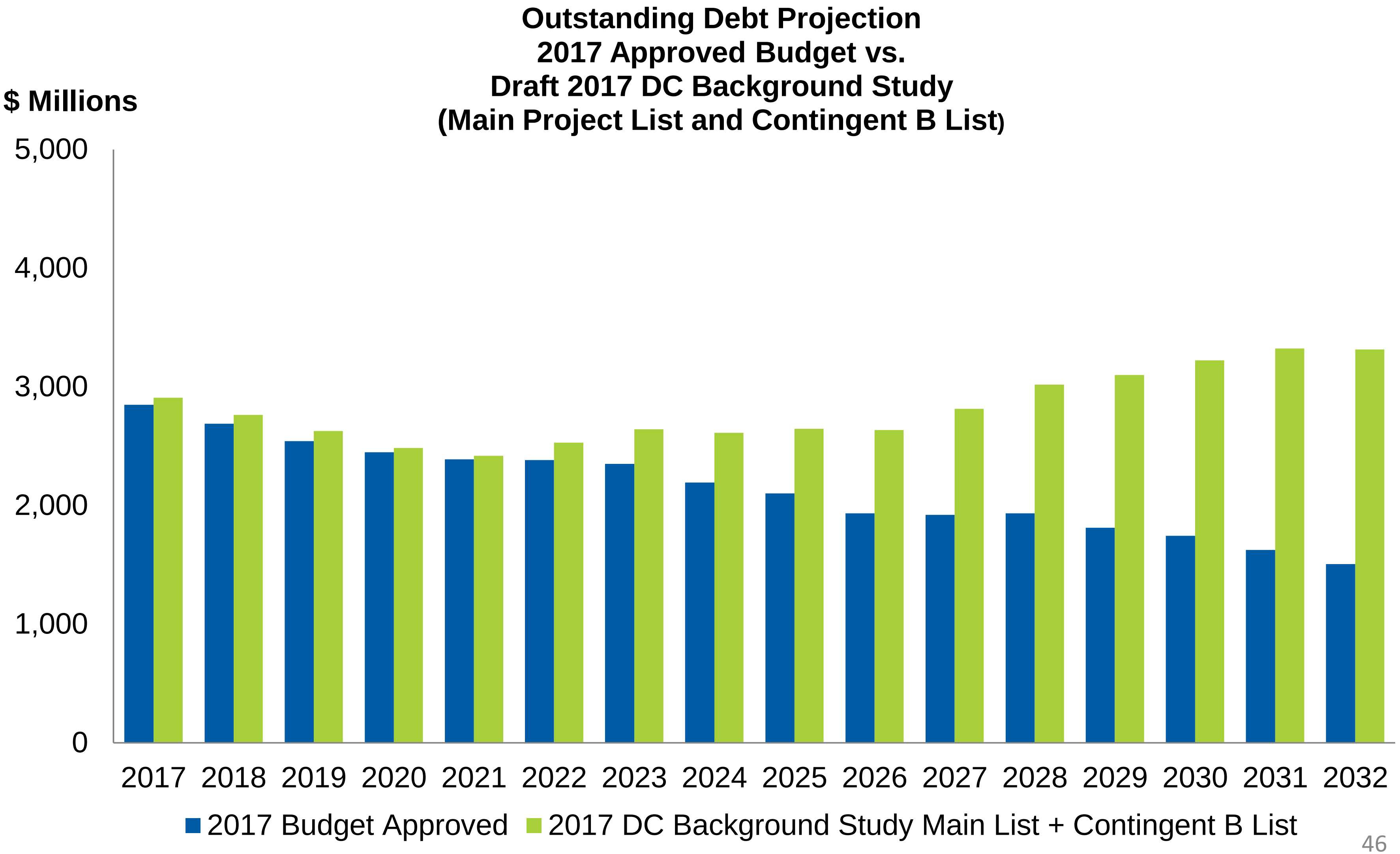


Lower-than-expected DC collections would mean some combination of more debt or capital deferrals

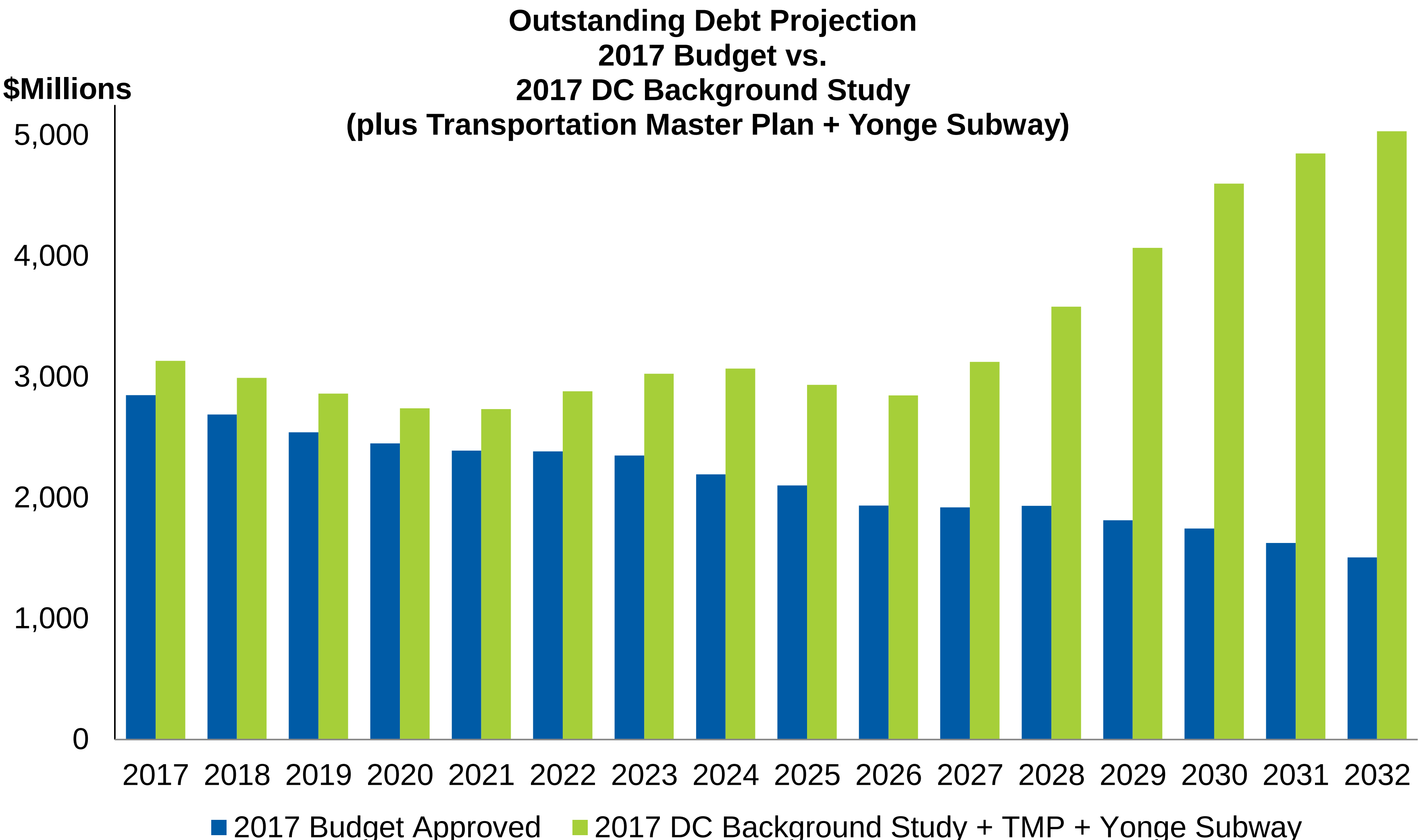
The draft DC Background Study projects would result in significantly higher debt



The Background Study plus the Contingency B list would result in still higher debt



With the Transportation Master Plan and Yonge Subway added to the Background Study, the debt would be even higher



New revenue sources could allow projects to be added to the capital plan without increasing debt

- The Region could consider a DC debt reduction reserve (similar to the current tax levy debt reduction reserve) to temporarily fund the DC portion of growth-related projects not currently in the capital plan
- Draws on the reserve would be repaid through development charge collections

	$ Millions
Annual seeding of DC debt reduction reserve	90

Key messages

- Debt management remains a significant challenge for the Region
- The Region needs approximately $215 million per year in additional revenue to achieve long-term financial sustainability:

	$ Millions
Tax levy fiscal gap	125
Annual seeding of DC debt reduction reserve	90
Annual requirement for long-term financial sustainability	**215**

Increasing Revenue

Two questions

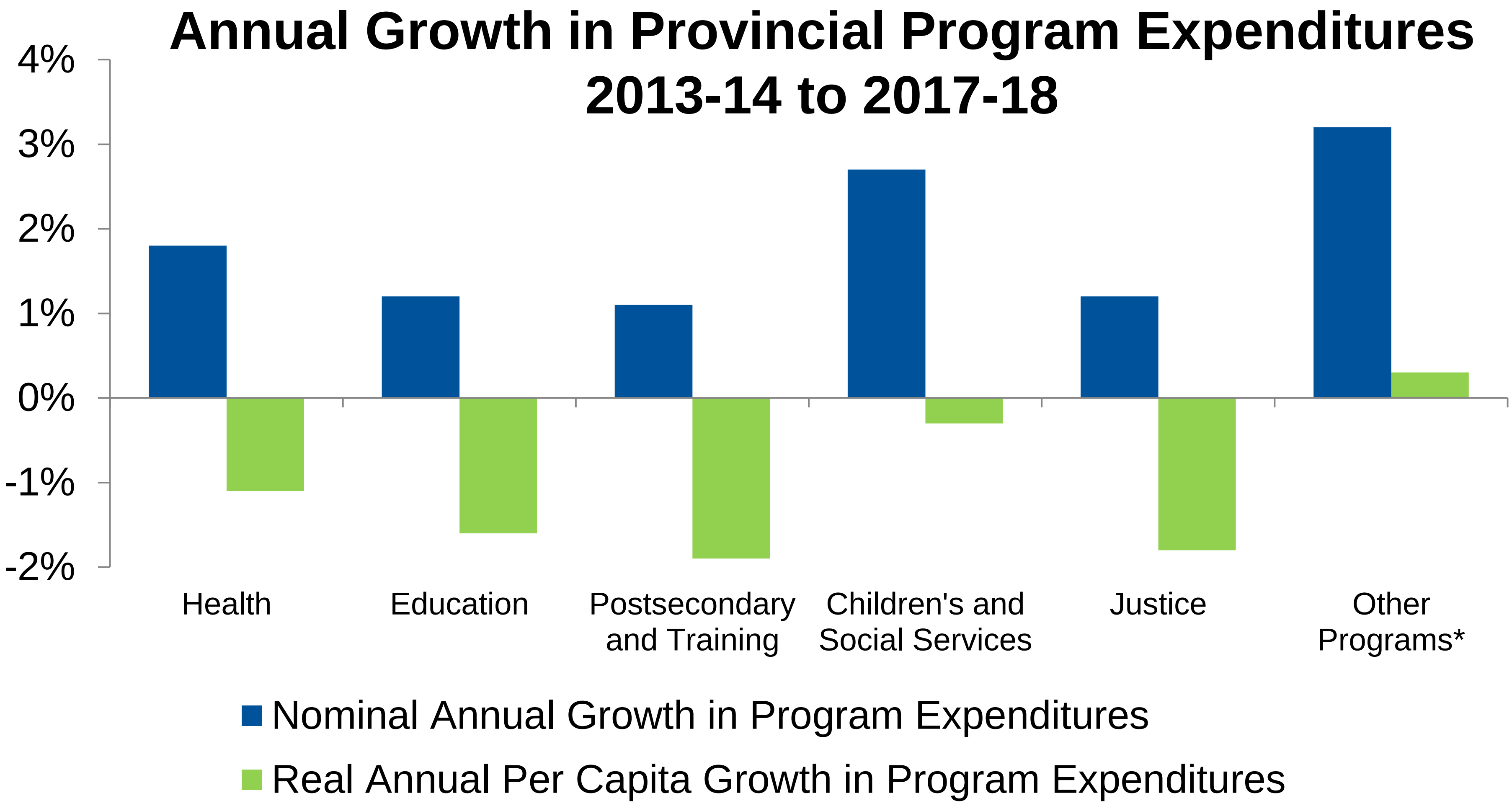
- Will the Province give municipalities big new revenue sources?
- If not, what new revenue sources might be workable in the current context?

AMO's What's Next campaign is targeting big generators of tax revenue that reside with the Province

Different Financing Tools for Different Services			
Private	**Public**	**Redistributive**	**Spillovers**
Water Sewer Garbage Transit	Police Fire Local parks Streetlights	Social assistance Social housing	Roads/transit Culture Social assistance
User Fees	Property Tax Sales Tax	Income tax	Transfers

Source: Kitchen and Slack, "More Tax Sources for Canada's Largest Cities: Why, What, and How?"

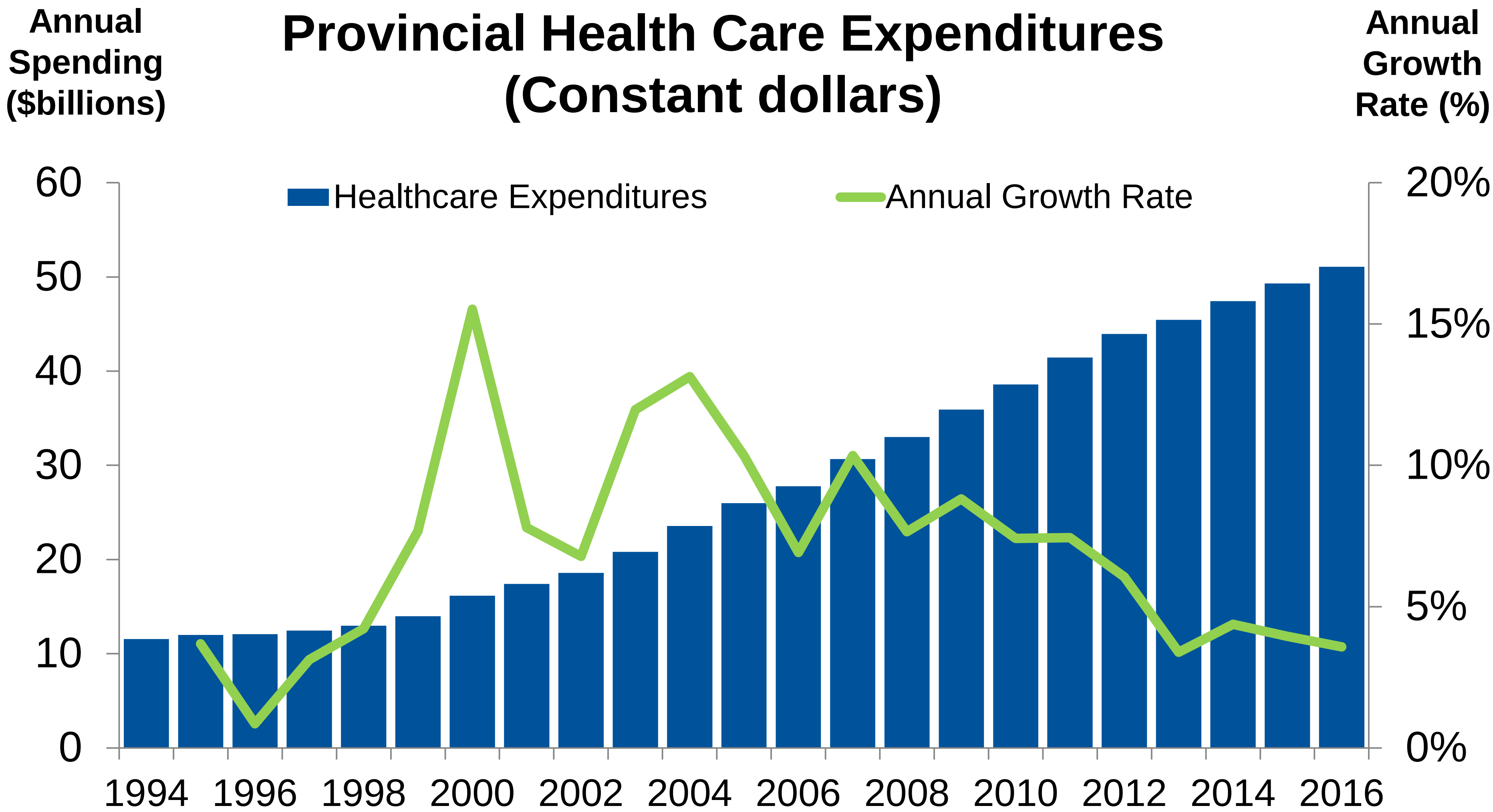
But the Provincial fiscal plan is very challenging



Source: Ontario Budget 2016: Section B: Fiscal Outlook, Table 3.18 and York Region Finance Department

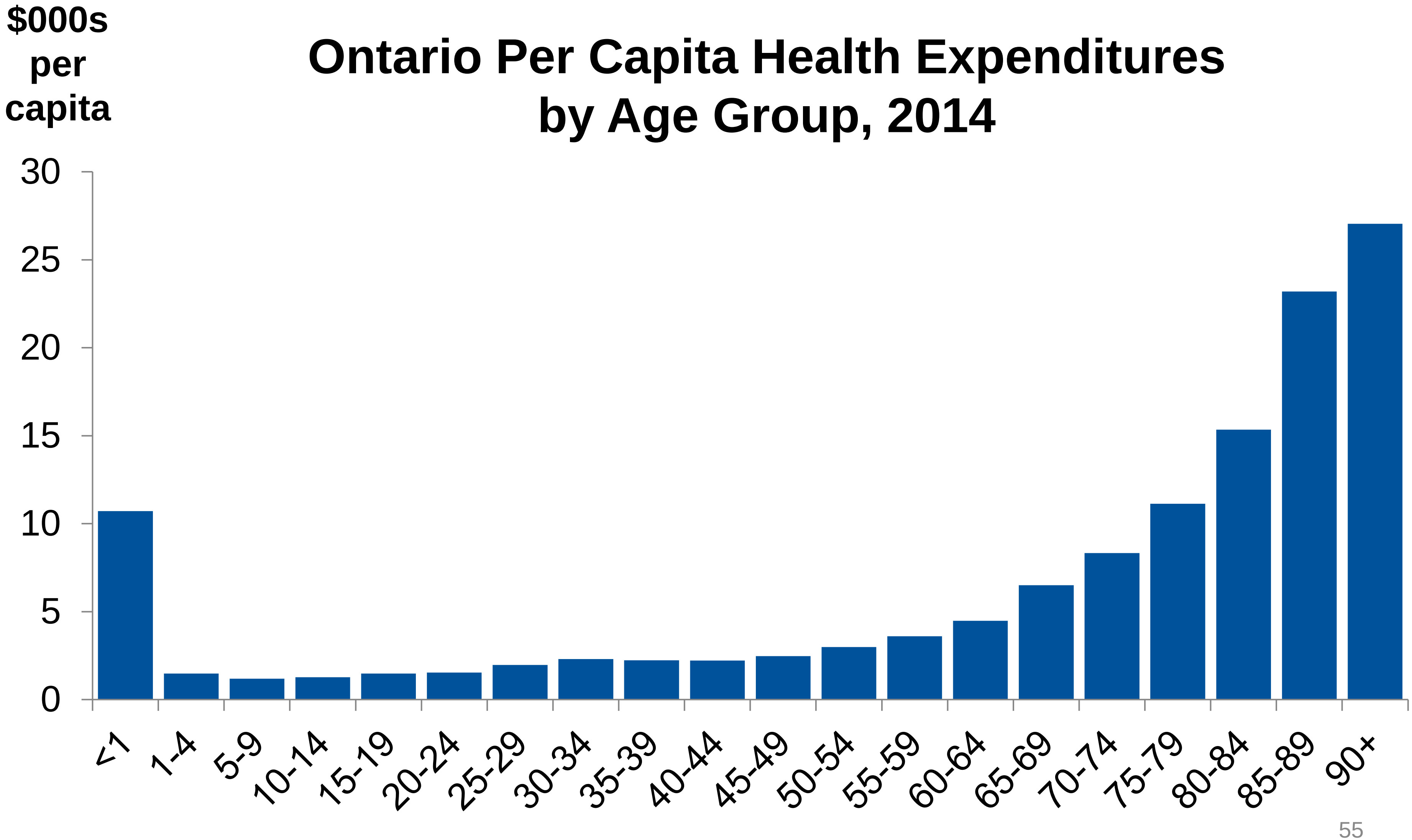
*Includes transportation, tourism, economic development, employment, agriculture, employee and pensioner benefits, housing and natural resources. Does not include interest on debt.

And the elephant in the room is health care



Source: Ontario Public Accounts, 1994-95 to 2015-16; Statistics Canada
Annual spending is in constant 2016 dollars

A tsunami of cost is about to hit the system with the aging of the baby boom



Source: National Health Expenditure Database, 2014, Canadian Institute for Health Information.

The Province is unlikely to come to the rescue

- Uploads agreed to as part of the Provincial-Municipal Fiscal and Service Delivery Review will come to an end in 2018
- The Province will be reluctant to cede its big revenue generators to municipalities
- New municipal revenue sources will likely require municipal political accountability

The City of Toronto Act provides revenue-raising powers, which the city must choose to exercise

City of Toronto Act (2006) – Permitted Taxation Options	Revenue Estimate for York Region (if implemented)
Implemented by Toronto	
Municipal Land Transfer Tax	$200 to 250 million
Personal Vehicle Registration Tax	$67 to 80 million
Third Party Sign Tax	N/A
Not Implemented by Toronto	
Alcohol Tax	N/A
Tobacco Tax	N/A
Amusement Tax	N/A
Road Tolls	N/A

Key messages

- City of Toronto Act revenue-raising powers may be a path to additional revenue for the Region (and potentially other municipalities)
- The province would need to put an appropriate legislative and regulatory environment in place

Conclusion

If new revenue sources become available, they could be allocated to capital

- Fund the non-development charge recoverable portion of growth-related capital
- Address future unmet asset management needs
- Provide funding for municipal share of mega-projects
- Allow more projects to be included in the development charge bylaw

- Accelerate implementation of the Transportation Master Plan
- Enable investment in infrastructure that is not development charge eligible or mostly ineligible
- Help ensure that current prohibition on tax levy debt can remain
- Enable faster debt reduction

Conclusion

- Long-term financial sustainability cannot be achieved within the current provincial-municipal fiscal framework
- New revenue sources are necessary to address both **growth management** and **asset management** needs, since the property tax increases and debt increases that would be needed are not likely to be acceptable for the foreseeable future
- A feasible option may be for Growth Plan upper and single tier municipalities to seek the revenue powers available under the *City of Toronto Act*