

Finance
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2005 BUDGET BRIEFING NOTE: GTA Equalization

Issue/Background:

As part of the “Who Does What/Local Services Realignment (LSR)” process, municipalities throughout Ontario became responsible for funding social housing costs and an increased share of social services costs as of January 1, 1998. The City holds the position that it is inappropriate to fund income re-distributive programs such as social assistance and social housing from the property tax base.

Toronto carries a disproportionate share of each of these portfolios in the GTA (80% of social assistance clients and 74% of social housing stock). In recognition of this disparity, and its negative fiscal impact on the City, and to assist with the goal of making LSR more revenue neutral to all municipalities, the Province made the decision to share or equalize (pool) these costs among GTA municipalities.

Under equalization, each region’s/city share of the GTA wide costs is determined by its proportionate share of weighted average (by tax ratios) assessment in the GTA. The Province regulates this calculation.

Toronto is a net beneficiary of GTA equalization, receiving equalization payments from the other GTA participants. Viewed in another way, after equalization this cost sharing arrangement results in Toronto funding slightly over 50% of the total GTA municipal expenditures for these programs, rather than the 70-80% of the GTA costs that arise within its borders.

Key Points:

A. City’s share of GTA equalized costs

The Weighted Average Assessment cost allocation formula, as established by the Province, is as follows:

$$\begin{array}{r} \text{Share of Weighted Average Assessment (by City/Region)} \\ \times \\ \text{Total GTA Municipal pooled program expenditures} \\ = \\ \text{Share of GTA pooled program expenditures} \end{array}$$

The effect of this formula is to allocate costs in proportion to the amount of property tax revenue that would be collected if each municipality had the same (average) tax ratios. In this way the formula is a compromise between a raw assessment based allocation and a tax revenue based allocation.

The City's share of Weighted Average Assessment since 1998 is shown in the table below. It tends to decline each year due to assessment growth in the 905 Regions outpacing that of the City of Toronto, offset by CVA reassessments which tend to increase the City's share, especially in 2002.

<u>1998</u>	<u>1999</u>	<u>2000 (1)</u>	<u>2001</u>	<u>2002 (2)</u>	<u>2003</u>	<u>2004 (2)</u>	<u>2005 (3)</u>
52.2%	51.6%	51.6%	50.9%	54.0%	53.0%	53.0%	51.4%

- (1) One-year lag introduced for administrative reasons.
- (2) CVA reassessment impact.
- (3) Preliminary, to be confirmed by Ministry of Finance.

The 2005 estimate incorporates transition ratios that were amended by regulation in Toronto and York in 2004. These new ratios are responsible for 1% of the reduction in the City's share from 2004 to 2005, reducing the City's net costs by approximately \$4.8 million (social assistance) and \$4.1 million (social housing).

A summary of pooled program costs since 1998 is included as an attachment to this note. The pooled municipal cost of social service and social housing for the GTA had been declining through 2001, primarily as a result of declining Ontario Works caseloads and lower mortgage rates. However, it appears this trend has ended, especially for social assistance (see attached).

B. Social Services

As a Consolidated Municipal Service Manager (CMSM), the City of Toronto is responsible for managing, funding (through cost sharing) and delivering the mandatory OW program, as well as cost-sharing the provincial Ontario Disability Support Program (ODSP). Over the past three years, Toronto's caseload as a proportion of the GTA's total caseload has remained steady, at approximately 79 percent of the total.

Only social assistance costs approved by the Province are eligible for cost sharing and pooling. Provincial regulations/directives dictate what benefits and services are provided under Ontario Works across the province. Program delivery costs (cost of administration) incurred by the City above a certain threshold as determined by the Province are not eligible for OW funding (they must be funded 100 percent by municipalities), and are not be included in the pooling formula. The Provincial threshold ignores uncontrollable costs such as COLA, collective bargaining, cessation of OMERS holiday, and inflation. However the Province has not imposed a 'cap' on its own ODSP cost of administration, which increased over 11% between 2002 and 2003, and borne by GTA municipalities.

The Province is responsible for administering the pooling process for social services. The Province has only recently provided a final reconciliation for GTA pooling obligations for 2002 and 2003, which will result in a shortfall of \$2.0 million from revenues recorded by the City in closing its books in 2002 & 2003. Pooling reconciliation is critical in determining the annual estimate for 'pooling' transfers from 905's to the City, especially in a period when significant cost increases are being realized from provincially administered programs (ODSP and ODB).

As reported to the Policy and Finance Committee, Community and Neighbourhood Services staff has been advised verbally by the Ministry that pooling revenue for 2004 is estimated to be \$92 million, resulting in a shortfall of \$4.3 million (based on the projected 2004 caseload) when compared to City staff expectation. City staff has requested details on this shortfall.

Budgeting for pooling remains fraught with uncertainty since final prior year data is often unavailable and pooling revenues are based on total GTA expenditures, not just Toronto expenditures. The program's best estimate of a pooling revenue contingency requirement for 2005 is \$7.5 million (if the budgeted average monthly OW caseload of 72,000 cases materializes). This amount has not been included in the budget but has been earmarked as a potential draw against the Social Assistance Stabilization Reserve Fund.

Social Assistance Equalization Payment History

	(\$ millions)				
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2002- 2004</u>	<u>2005</u>
City Budget (based on budgeted caseload)	103.3	99.2	104.2	306.7	104.2
Received	87.5	92.2	92.2*	271.9	

* 2004 pooling revenue is verbally confirmed by the Province.

C. Social Housing

Eligible Costs for Equalization Purposes

When the Province determined that financial and administrative responsibility for the social housing program would be devolved to the municipalities in 2001 – 2002, after which budgets and costs would no longer be set or cleared through the Province, it was recognized that a different system for establishing eligible costs for GTA equalization purposes would be required.

Accordingly, GTA Finance and Housing Program staff and MMAH officials had been meeting since before devolution to develop a basis for an index (GTA) model for annually determining costs for pooling purposes, and had agreed that it should comprise the following:

- a) a base year of 2001 actuals, excluding anomalous Federal funding in that year.

- b) a short list of key cost and revenue categories for indexing.
- c) indices (identified) for each cost/rev category.
- d) a model for identifying eligible mortgage costs, while maintaining an option for local accountability for mortgage strategy related to renewals (as developed by MMAH).

and be applied to the years 2002 through 2005, after which time the entire feasibility of equalization was to be revisited in recognition of changing federal funding roles, municipal capital cost exposure and the anticipated introduction of new cost benchmarking legislation.

Use of such a model was to provide; a) predictability to annual budgets, b) incentive for each municipality to achieve savings against indexed costs / revenues (i.e benchmarks) and c) avoid costly administrative processes (i.e audit of each other's financials). Although the model pools operating cost increases by using inflation indices, capital cost risk (extraordinary redevelopment or maintenance cost) would be borne locally.

The model identified the potential future cost pressures for each municipality, and the related pooling payment/revenue consequences. The relative size in each municipality of the various cost & revenue categories (such as differences in the amount of public housing, proportion of mortgage debt, utility costs, proportion of rent geared to income units, market rents, the number of older units with higher capital repairs, etc) gives rise to different future cost profiles in each municipality, and significant growth in projected pooling payments to Toronto over time.

In apparent deference to concerns expressed by GTA regions outside Toronto about the City's cost profile, Municipal Affairs Ministry staff have indicated that the Ministry does not intend to use the model to reconcile costs for 2002 through 2004, or for budgeting purposes for 2005. Instead, Ministry staff indicate that municipalities should expect the pooling payment to be based on a fixed payment figure of approximately \$79 million, that is derived from the Ministry of Finance's Community Reinvestment Fund (Local Services Realignment compensation) calculation as at devolution of the program (2002). City staff oppose this artificial cap and have suggested that this is contrary to the Province's Social Housing Reform Act, and Social Housing benchmarking legislation, and leaves the City exposed to rising program costs, while other GTA regions benefit from windfall mortgage savings. The table below compares these two methodologies and the impact to pooling payments to Toronto.

Equalization Entitlement Comparison

	(\$ millions)					
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>'02 - '04</u>	<u>2005</u>	<u>Total</u>
GTA model estimate	77.8	86.4	89.0	253.2	98.6	351.8
Fixed model	74.3	78.7	78.9	231.9	78.9*	310.8
Difference	3.5	7.7	10.1	21.3	19.7	41.0

* When weighted average assessment shares are applied in accordance with the legislation,

the 2005 fixed cost formula amount would increase to \$85.6 (from \$79 million) as budgeted by the Shelter Housing & Support program in 2005. Ministry staff have yet to confirm the City's 2005 pooling revenue for budgeting purposes. Given this uncertainty, the EMT Recommended Budget includes a recommendation to fund this potential shortfall (\$7 million) from the Social Housing Reserve fund.

Equalization Payment Irregularities

Irrespective of the dispute over how eligible expenditures are to be determined for equalization purposes, the City also has issues with the timeliness of payments. Monthly equalization payment requirements are established by the Ministry each year, subject to year end reconciliation. Errors by the Ministry resulted in the requirement for \$13.2 million in retroactive pooling payments in favour of the City in respect of 2003 (in 2004), but without any interest compensation. The payment schedules themselves are often issued well into the year, resulting in initial payments being months behind schedule. The other GTA regions have often been in arrears compared to the schedule (\$8.8 million at December 31, 2004), costing the City additional interest revenue. And finally, the Ministry of Municipal Affairs has under billed the other GTA regions \$5 million from 2002 in discord with its proposed fixed model approach. The current status of payments is summarized in the table below.

Housing Equalization Payment Status (as at Dec 31, 2004)

	(\$ millions)			
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2002- 2004</u>
City Budget	76.5	69.8	77.5	223.8
Billed	69.2	78.7(*)	78.9	226.8
Received	<u>69.2</u>	<u>76.6</u>	<u>72.2</u>	<u>218.0</u>
Over-due	0.0	2.1	6.7	8.8
Under Billed	<u>5.0</u>	<u>0.0</u>	<u>0.0</u>	<u>5.0</u>
Total Outstanding	5.0	2.1	6.7	13.8

(*) Includes \$13.2M 'retro' payment.

Status of Discussions

The Ministry of Municipal Affairs made efforts to facilitate discussions at the CAO level to resolve equalization issues. Although no meetings have occurred since last spring, through correspondence and conference calls the GTA regional CAOs have indicated that they are not interested in recommending a position to their Councils for the 2002 – 2005 period without assurances that equalization will be phased out over the longer term.

City staff have requested that the Province implement the indexed model for the 2002 – 2005 period as the only reasonable way to set eligible costs over that period. However, over the longer term, municipalities will face increasing program costs particularly in

Toronto due to capital refurbishment requirements, utility costs, phase-out of federal subsidies, interest rate exposure, and tenant subsidy requirements, and service demand. These pressures make the program unsuitable for continued funding from the property tax base, whether or not these costs are equalized across the GTA.

Consequently City staff have suggested that a greater Provincial role is required in supporting the cost of the existing housing program. Some possibilities include a) working to convince the Federal government to maintain its current funding levels, b) freezing municipal contributions and funding cost increases from Provincial revenues, c) uploading the funding responsibility of all or a portion of the program – starting with the public housing portfolio which is responsible for a large portion of equalization requirements, or d) implementing a regional growth-tax surcharge to fund all or a portion of the program. These options must be in addition to support for the expansion of social housing stock already underway or under consideration.

Conclusion:

GTA equalization is a creation of the Province, designed to alleviate the negative impacts of the LSR process on Toronto by compensating for the disproportionate share of the social services and social housing portfolio expenditures in Toronto.

Under equalization total eligible GTA expenditures are allocated based on a weighted average assessment costs sharing formula. The Province has yet to confirm the applicable cost shares for 2005.

For social services, prescriptive regulation and Ministry directives govern program cost eligibility for Provincial cost sharing and pooling. The City's concern is that costs and equalization payments for prior years have not been finalized on a timely basis, resulting in financial exposure due to potential retroactive adjustments, and difficulty in setting appropriate budgets. Additionally, the City has well documented concerns about the Province's use of capping eligible expenditures for cost sharing purposes, and exposure to increases in Provincially administered program costs.

Social housing expenditures and equalization of costs in the GTA are mandatory under the Social Housing Reform Act. A working group made up of GTA and Provincial staff had been working on a process to establish and budget eligible costs after program responsibility had been devolved to the municipalities. An indexed model was developed to identify appropriate equalization payments, however Ministry staff indicate that a fixed transfer payment has been used for 2002 – 2004, and should be assumed for 2005 budgeting purposes. The loss of 'pooling' revenues to the City resulting from this position is estimated to be up to \$41 million over four years, including up to \$19.7 million for 2005, depending on the actual cost shares.

Under the Province's social housing equalization proposal, City staff contend that the Province under billed for equalization in 2002 by \$5 million. Also, the Province has not always ensured that payments are processed in a timely manner. As at December 31, 2004 \$8.8 million was overdue, and the Province has yet to produce an equalization

payment schedule for 2005. It is critical that at a minimum these issues be addressed before considering the appropriate process required to consider long term solutions.

The Assistant Deputy Minister of Municipal Affairs is seeking to re-establish a housing equalization steering group of municipal staff representatives to discuss long term issues and air other issues early in 2005.

Contact for further information:

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Attachment
Summary of Pooled Program Expenditure Estimates
(\$ millions)

i) City cost before Equalization: 1998 – 2005								
	1998	1999	2000	2001	2002 (F)	2003 (F)	2004 (F)	2005 (B)
<u>Toronto</u>								
Social Services	359.8	333.8	325.3	314.9	317.1	325.9	330.8	346.4
Social Housing	<u>325.3</u>	<u>315.9</u>	<u>297.7</u>	<u>305.8</u>	<u>310.8</u>	<u>310.8</u>	<u>310.8</u>	<u>301.6</u>
Total	685.1	649.7	623.0	620.7	627.9	636.7	641.6	648.0
<u>GTA Total (see Note (iv) below)</u>								
Social Services	483.7	444.5	432.6	418.6	425.1	441.0	450.9	470.9
Social Housing	<u>463.0</u>	<u>452.5</u>	<u>426.4</u>	<u>421.6</u>	<u>437.9</u>	<u>438.0</u>	<u>437.9</u>	<u>420.0</u>
Total GTA	946.7	897.0	859.0	840.2	863.0	879.0	888.8	890.9
City Share of GTA (%)	72.4%	72.4%	72.5%	73.9%	72.8%	72.4%	72.2%	72.7%
ii) City costs after Equalization: 1998 – 2005								
	1998	1999	2000	2001	2002 (F)	2003 (F)	2004 (F)	2005(B)
Social Services	252.7	229.2	223.1	213.0	229.6	233.7	238.8	242.2
Social Housing	<u>241.9</u>	<u>233.3</u>	<u>219.9</u>	<u>214.5</u>	<u>236.5</u>	<u>232.1</u>	<u>231.9</u>	<u>216.0</u>
Total	494.6	462.5	443.0	427.5	466.1	465.8	470.7	458.2
City Share of GTA (%)	52.24%	51.57%	51.57%	50.88%	54.01%	52.99%	52.96%	51.43%
iii) Equalization Payments – GTA Pooling Revenue								
	1998	1999	2000	2001	2002 (F)	2003 (F)	2004 (F)	2005 (B)
Social Services *	107.1	104.6	102.1	101.9	87.5	92.2	92.0	104.2
Social Housing	<u>83.4</u>	<u>82.6</u>	<u>77.8</u>	<u>91.3</u>	<u>74.3</u>	<u>78.7</u>	<u>78.9</u>	<u>85.6</u>
Total	190.5	187.2	179.9	193.2	161.8	170.9	170.9	189.8
(C) Social Housing – GTA Pooling based on “Indexed Model”					77.8	86.3	88.9	98.6

F = Forecast

B = Budget estimates

C = Social housing based on GTA model 2002 – 2005

* = Social Services: starting 2001, only OW administration costs within the Provincial ‘cap’ are included in the equalization calculation.

Data Sources :

- i) Social Services 1998 – 2003: as confirmed by Ministry of Community & Social Services
- ii) Social Services 2004 estimate actual gross expenditures, pooling revenues as estimated by Ministry of Community & Social Services.
- iii) Social service 2005: estimated by City (excludes certain ineligible admin costs).
- iv) Social Housing 1998 – 2000 reconciled by Ministry of Finance.
- v) Social Housing 2001: reconciled, but not final.
- vi) Social Housing 2002 – 2004 Provincial estimates CRF model.
- vii) Social Housing 2005 – City Budget