

TORONTO STAFF REPORT

July 7, 2004

To: Ad Hoc Committee on the Development of a Long-term Fiscal Plan

From: Chief Financial Officer & Treasurer

Subject: Overview of Debt Loads and Credit Ratings of Major Canadian Municipalities (2003)

Purpose:

To respond to a request by the Ad Hoc Committee on the Development of a Long-term Fiscal Plan at its meeting on May 26, 2004 with respect to a review of other municipalities' practices regarding debt loads, credit ratings, etc.

Financial Implications and Impact Statement :

There are no financial implications as a result of the adoption of this report.

Recommendations :

It is recommended that this report be received for information.

Background :

City Council at its meeting on June 22 to 24, 2004 adopted the recommendation in the consolidated Clause No. 9 in Policy and Finance Committee Report 5 titled "Terms of Reference for Long-term Fiscal Plan Committee". Further, the Ad Hoc Committee on the Development of a Long-term Fiscal Plan, at its May 26, 2004 meeting, requested, amongst other things, that the Chief Financial Officer and Treasurer (CFO) submit a report on a review of other municipalities' practices regarding debt loads, credit ratings, etc.

Comments :

Credit ratings provide an independent assessment of the credit quality of a debt issuer. Dominion Bond Rating Service (DBRS) has recently released its 2003 review (based on 2002 results) of eight Canadian municipal governments— Vancouver, Edmonton, Calgary, Winnipeg, Toronto, Ottawa, Hamilton, and Peel (region). Similarly, Standard and Poor's (S&P) issued its Industry Report Card for Canadian Municipalities, reviewing the performances of 35 Canadian

cities in 2003 including Toronto. The themes and key points contained in the respective reviews are summarized in the following sections.

A. Dominion Bond Rating Service (DBRS)

The fiscal positions of the eight municipal governments remained quite strong, and compared favourably with historical results. However, after several years of improved fiscal results, most municipalities included in this study experienced a modest weakening in 2002 due to lower net earnings realized by subsidiary energy corporations, expanded spending programs, and higher labour costs. Ongoing growth in spending, fuelled by labour and capital maintenance, will likely start cutting into the fiscal results in the next few years.

The following table compares the DBRS credit ratings (for long-term debt) amongst the above-mentioned eight municipal governments:

	Peel	Vancouver*	Edmonton	Ottawa **	Hamilton *	Toronto	Calgary	Winnipeg
Credit rating	AAA	AA (high)	AA (high)	AA (high)	AA (high)	AA	AA	AA (low)

* Vancouver and Hamilton received negative rating actions in 2003, while all others exhibited stable trends:

Vancouver – downgraded from AAA due to the continued increase of net tax-supported debt













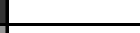






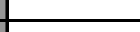








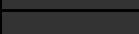
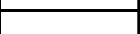


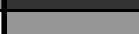
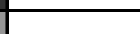






















Hamilton – trend change from Stable to Negative due to deteriorating outlook for net tax-supported debt

** Ottawa – While long-term rating was unchanged, the trend remained Negative for the second year, reflecting uncertainty over the City’s ability to meet medium-term capital requirements

While assessing the creditworthiness of municipalities, DBRS considers mainly seven factors which are displayed in the following table as column titles. Municipal credit ratings are determined based on the relative risks around the seven factors. A black box indicates a high risk or an item that poses a greater challenge to a municipal government, while a white box indicates a low risk and hence, a positive consideration for its credit rating. A grey box indicates medium risk, and is neutral for the rating.

Rating Considerations

Relative Risk: High  Moderate  Low 

	Long-term Debt Rating	Net tax-supported debt per capita	Core surplus/ (deficit) after capital expenditures	Capital financing pressures	Economy & taxable assessment	Tax & user fee burden	Liquidity position	Risk profile & responsibilities
Toronto	AA							
Ottawa	AA (high)							
Hamilton	AA (high)							
Peel	AAA							
Winnipeg	AA (low)							
Calgary	AA							
Edmonton	AA (high)							
Vancouver	AA (high)							

* Debt includes contingent liabilities and long-term commitments

These eight municipalities, which are located in four provinces with different jurisdictions, have quite different roles and responsibilities, which may explain the above-mentioned relative risks.

	Ontario Municipalities	Winnipeg	Calgary & Edmonton	Vancouver
Social Housing	Yes	No (1)	Yes (2)	No (3)
Social Assistance	20% municipality, 80% Province	Cost to Winnipeg fixed at \$18M/yr	No	No
Public Health	Province covers 50% of eligible costs	No	No	No
Police & Fire Services	Yes	Yes	Yes	Yes
Water & Sewer	Yes	Yes	Yes	Yes (4)
Solid Waste Disposal	Yes	Yes	Yes	Yes
Public Transit	Yes	Yes	Yes	No (5)
Education Property Tax Collection	Yes	Yes	Yes	Yes

- (1) Province of Manitoba is responsible for delivering social services, but the City of Winnipeg provides partial funding
 (2) Calgary & Edmonton have housing corporations that are largely funded by senior levels of government
 (3) Vancouver delivers Social Housing services, but is fully reimbursed by the Province of British Columbia
 (4) Vancouver's water & sewage treatment services are performed by a 3rd party & partially funded through municipalities
 (5) Vancouver's public transit is the responsibility of the regional government, with service provided by a 3rd party & partially funded through municipalities

Ontario's municipalities have high risk profile because they are responsible for some income distributive programs which are dependent on the economy (100% of Social Housing, 20% of Social Assistance, and 50% of Public Health costs). These responsibilities are significantly different from those of Winnipeg, Calgary, Edmonton and Vancouver. In addition, exposure to negative policy changes is most evident in Ontario municipalities, where the ability to raise property taxes on certain tax classes was capped by Bill 140.

Of the eight cities included in the review, those showing improved operating results in 2002 were:

- (a) Toronto, which was driven by healthy growth in user fee revenues with broad-based underspending across most city departments; and
- (b) Winnipeg, which was propelled by a substantial gain on the sale of its electric subsidiary corporation.

In its rating considerations for the City of Toronto (AA Stable), DBRS recognized Toronto's strengths and challenges:

Strengths:

- (i) Strong and diversified economy
- (ii) Good fiscal management
- (iii) Ownership of Toronto Hydro Corporation
- (iv) Strong financial control

Weaknesses:

- (i) Ongoing management of capital funding pressures

- (ii) Uncertainty regarding provincial and federal funding
- (iii) Heavy business property tax burden
- (iv) Exposure to economy-sensitive program expenditures
- (v) Relatively high employee benefit liabilities

The attached appendix consists of 12 select financial and economic indicators (based on 2002 data), comparing Toronto with the other seven counterparts. Overall, Toronto fared relatively well.

Figure 1 — Operating revenues by function

Ontario municipalities, including Toronto, display the highest weightings of funding from other orders of government. However, this does not mean a higher level of other government support, but rather a reflection of additional funding intended to partially cover the costs of delivering social services and housing, responsibilities that are not held by most of the other municipalities.

Figure 2 — Surplus/(deficit) after capital expenditure per capita

Toronto is in the middle of the pack, with Winnipeg having the highest surplus and Ottawa having the highest deficit on a per capita basis.

Figures 3 and 4 — Capital expenditures

Toronto is in the middle of the pack on a per capita basis, but is the lowest when calculated as a percentage of the total expenditures, partly because of its capital maintenance deferral. Capital expenditures in proportion to total expenditures has been trending particularly low and stable for more mature cities such as Toronto, Winnipeg, Hamilton & Vancouver, but larger for cities that experience the highest level of population growth, e.g. Calgary & Peel.

Figure 5 — Local taxable assessment growth

Toronto is the lowest at 0.6%, with Edmonton being the highest at 9.3%, followed by Winnipeg (6.6%), Calgary (6.5%), etc.

Figure 6 — Total property taxes and user fees per capita

Toronto is the highest at \$2,425, followed by Ottawa (\$2,187) & Vancouver (\$1,953), etc.

Figures 7 to 10 — Net debt and debt burden

In absolute dollar terms, Toronto has the highest net tax-supported debt (\$1.1 billion), but it is in the middle of the pack when considered on a per capita basis and as a % of taxable assessment. When all long-term liabilities (tax-supported debt, contingent liabilities and other long-term commitments) are compared on a per capita basis, Toronto is also in the middle of the pack.

Figure 11 — Liquid assets / current liabilities

Toronto is the lowest, but still greater than 1, meaning all municipalities have strong liquidity and investment positions, and are in a comfortable position to repay short-term liabilities. Peel has the highest short-term liquidity with a ratio of 11.9:1.

Figure 12 — Unemployment rate

Toronto's rate was the second highest at 7.7%, trailing Vancouver's rate at 7.8%.

B. Standard & Poor's (S&P)

In April 2004, Standard & Poor's (S&P) issued its Industry Report Card for Canadian Municipalities, reviewing the performances of 35 Canadian cities in 2003. The general theme is similar to that of the DBRS report.

Key points:

- (i) Near-record economic performance, declining debt levels and generally strong operating performances
- (ii) Improved reporting standards under the Public Sector Accounting Board, with the inclusion in the balance sheet of retirement and post-employment benefits, landfill post-closure costs, and changing the treatment of development charges to a liability
- (iii) A significant number of municipalities regularly post operating surpluses that exceed 20% of operating revenues, which provides the necessary financial flexibility to fund capital programs, and cushion economic and financial shocks
- (iv) Trending towards growing infrastructure deficiencies and declining liquidity levels
- (v) "Canadian financial conservatism" and the Canadian intergovernmental system have resulted in most Canadian municipalities preferring to fund large capital projects at least partly from prior savings.
- (vi) Toronto's rating was AA/Stable (long-term debt) / A-1+ (short-term debt)
 - 1. Toronto's economy is the country's strongest and most diverse.
 - 2. Direct debt as a share of operating revenue was about 40% at the end of 2002, placing Toronto in an intermediate position with international peers
 - 3. Debt has been rising
 - 4. Liquidity levels are healthy
 - 5. Recent operating performances (surpluses) have not been strong, averaging 8% of operating revenues from 2000 to 2002

Conclusions:

Reviews prepared by both the Dominion Bond Rating Service and Standard & Poor's on Canadian / Ontario municipal governments in 2003 concluded that the City of Toronto's fiscal position was relatively quite strong. It has had near record economic performances since amalgamation, relatively stable debt levels and generally strong operating performance. However, ongoing growth in spending, fuelled by labour and capital requirements, uncertainty regarding provincial and federal funding, and relatively high employee benefit liabilities will start cutting into the fiscal results in the next few years.

Toronto's credit rating for long-term debt is currently rated AA (DBRS) and AA/Stable (S&P). This rating is behind those for Peel, Edmonton, and Vancouver. This is mainly due to the fact that Toronto (and other Ontario municipalities) has a higher risk profile associated with exposure to economy-sensitive income-distributive programs. Businesses in Toronto face relatively higher business property taxes, which the credit rating agencies regards as a weakness. Toronto has the highest property taxes and user fees per capita than the other major cities in Canada, while percentage assessment growth is the lowest. In absolute dollar terms, Toronto has the highest net tax-supported debt, but when considered on a per capita basis it is in the middle of the pack.

Contact:

Len S. Brittain
Director, Corporate Finance, Finance
Tel: (416) 392-5380
Fax: (416) 397-4555
Email: lbrittai@toronto.ca

Joseph P. Pennachetti
Chief Financial Officer & Treasurer

(P:\2004\Fin\Cf\lt04014Cf) – ts

List of Attachment:

Appendix A – Select Financial and Economic Indicators

Select Financial and Economic Indicators

Source: DBRS 2003 Canadian Municipal Government (published in Feb 2004 based on 2002 data)

