TORONTO

STAFF REPORT
ACTION REQUIRED

Toronto Pooling Compensation for Social Housing – Budget Strategy Follow up

Date:	February 12, 2015
To:	Budget Committee
From:	City Manager and Deputy City Manager & Chief Financial Officer
Wards:	All
Reference Number:	P:\2014\Internal Services\Cf\Bc15004Cf (AFS #20841)

SUMMARY

The purpose of this report is to respond to Budget Committee direction to recommend a short term financing strategy to replace the loss of Toronto Pooling Compensation (TPC) grants for Social Housing from the Province. At the same time, staff have recommended budget adjustments to begin to address the funding shortfall on a permanent basis in 2015.

The recommended strategy is based on spreading the budget impact of the TPC grants elimination over four years to allow time to identify budget adjustments to mitigate the revenue loss and a related increase in capital financing costs. The interim operating shortfall would be managed by temporarily reducing capital contributions in the operating budget by an aggregate of $130 million over three years, and commensurately increasing (short term) debt financed capital.

The recommended financing approach is to use internal borrowing rather than bank loans or public debenture issues, for reasons of administrative simplicity, cost and flexibility. The City's long term fiscal strategy would be maintained as the borrowing would be paid off within 6 years, Capital From Current funding fully restored, including scheduled increases, and, according to current forecasts, the debt service ratio maintained below the 15% of property tax revenues threshold. Nevertheless, staff propose to undertake a thorough review of the 2016-2025 capital plan to identify projects that might be deferred and report back to the Budget Committee early in the 2016 Budget process.

RECOMMENDATIONS

The City Manager and the Deputy City Manager & Chief Financial Officer recommend that:

1. City Council adopt a 4 year budget and capital financing strategy (as set out in Appendix 2) to deal with the elimination of Toronto Pooling Compensation grants, so as to fully address the budgetary impact of the associated revenue loss over four years (by 2018), and fully repay any resulting capital financing in 6 years (by 2020), comprising the following:

    a. a 4 year schedule of budgetary adjustments equivalent to $25.3million in 2015 and approximately $45 million in each of 2016 through 2018;
    b. the temporary reduction of Capital From Current ("CFC") to offset the remaining portion of the Toronto Pooling Compensation revenue loss not addressed by the budgetary adjustments in each of 2015, 2016 and 2017;
    c. the full restoration of CFC, including currently planned increases, by 2018; and,
    d. the issuance of City debt to the City's investment portfolio to replace the capital funding shortfall resulting from the temporary reduction of CFC, such debt to mature no later than 2020.

2. The Budget Committee address the $85.6 million Toronto Pooling Compensation revenue shortfall for social housing in 2015 by adjusting the 2015 Staff Recommended Operating Budget as follows:

    a. Reduce the 2015 Staff Recommended Operating Budgets by a total of $32.033 million gross and $25.3 million net for the following City Programs and Agencies (as set out in Appendix 1A and 1B):

        i. City Programs:
            - Toronto Employment and Social Services by $13.833m gross and $1.650m net;
            - Shelter, Support & Housing Administration by $0.500m gross and net
            - Childrens' Services by $0.150m gross and net
            - Transportation Services by $1.522m gross and net
            - Fire Services by $0.300 gross and net
            - Policy, Planning, Finance and Administration by $0.128m gross and net
            - Engineering & Construction Services by $0.050m gross and net
            - Fleet Services by $1.700m gross and net
            - 311 Toronto by $0.300m gross and net
            - Non-Program Expenditures by $5.0m gross and net
            - Non- Program Revenue by $4.0 million net

ii. Agencies:
   - Toronto Transit Commission by $4.0 m gross and $5.0m net
   - Toronto Police Services by $5.0m gross and net

and request the CEO of the TTC, and the Chair of the Toronto Police Services Board, to report to the final wrap-up meeting of the Budget Committee on February 20, 2015, to confirm the specific actions to meet these budget reduction targets, following consideration of potential items identified in Appendix 1B;

b. Reduce the 2015 capital contribution from the Operating Budget to the 2015 Staff Recommended Capital Budget (CFC) by $60.3 million; and,

c. Increase debt financing of capital projects by up to $60.3 million as described in Recommendation 1 (d).

3. The Deputy City Manager & Chief Financial Officer commence a detailed review of the City's 2016 – 2025 capital requirements as part of the City's 2016 Capital Budget process to ensure that debt affordability targets continue to be maintained, and report the results to Budget Committee early in the 2016 Budget process.

Implementation Points

The recommendations contained in this report would require City budgetary adjustments to address the Toronto Pooling Compensation funding shortfall to be phased in over four years, from 2015 through 2018, rather than immediately upon the elimination of the funding in 2015 and 2016. The strategy requires reduction of a portion of Capital From Current during the phase-in period, creating a temporary capital funding shortfall. Instead of relying on traditional debentures, a Provincial loan, or bank financing to fund the shortfall, staff recommend internal borrowing through the City's pooled investment program.

Financial Impact

The recommended budgetary impacts to deal with the elimination of $129 million in Toronto Pooling Compensation by 2016 comprise adjustments to 2015 budget expenditures and revenues in the amount of $25.3 million, plus a 5.1% tax-supported budgetary increase/pressure over 2016 – 2018, summarized as follows:

4 year Budget Strategy to Replace Pooling Compensation Revenue Loss
$ Millions

Table 1 – Revenue Loss	2013	2014	2015	2016	2017	2018
Original TPC schedule	$149.3	$142.5	$135.6	$128.8	$121.9	$115.1
TPC Elimination schedule	$149.3	$100.0	$50.0	0	0	0
Revenue Loss	0	($42.5)	($85.6)	($128.8)	($121.9)	($115.1)

Table 2 – Budget Impacts	2015	2016	2017	2018	2019	2020	2021
Revenue Loss	$85.6	$128.8	$121.9	$115.1	$115.1	$115.1	$115.1
Incremental Budgetary Adjustments*	$25.3	$44.0	$45.2	$46.2	-	-	($45.7)

*Includes interim financing repayment (principal and interest)

Table 3 – Borrowing Plan	2015	2016	2017	2018	2019	2020	2021
Borrowing	$60.3	$59.5	$7.5	-	-	-	
Short Term Interest @1.5%	-	$0.9	$1.8	$3.3	$2.2	$1.1	
Debt Repayment Charges	-	-	-	$45.5	$45.5	$45.5	
Net Amount Owing	$60.3	$120.7	$130.0	$87.7	$44.4	$0.0	
Future Residential Tax Increases and/or budget adjustments		1.7%	1.7%	1.7%	-	-	(1.6%)

Table 4 – CFC Impacts	2015	2016	2017	2018	2019	2020	2021
CFC Budget	$258.7	$198.4	$225.1	$305.6	$344.4	$378.8	$416.7
CFC Reduction (Incremental Impact)	($60.3)	$0.8	$52.0	$7.5	-	-	-
CFC Budget Growth		$25.9	$28.5	$31.3	$34.4	$37.9	$41.7
Revised CFC	$198.4	$225.1	$305.6	$344.4	$378.8	$416.7	$458.4

This approach spreads the budget impact of the revenue loss over 2015 – 2018, providing two more years to manage the resulting social housing budget pressure, and affording Council the opportunity to plan budget adjustments in advance, so as to minimize future tax impacts due to the loss of provincial funding.

The recommended 2015 net budget adjustments, as described in Appendix 1A and 1B, are summarized as follows:

Division/Agency	**$M**
Cluster A	
Employment and Social Services - reduced caseload to updated 2014 actuals	1.650
Shelter, Support & Housing - reduced mortgage costs/lower interest rates	0.500
Children Services – reduce part time hours to updated actuals	0.150
Total Cluster A	2.300
Cluster B	
Transportation – reduce vacant positions/increase parking permit revenue	1.522
Fire – reduce material and equipment expenses	0.300
PPFA – reduce non-salary costs	0.128
ECS – reduce contracted services for office space	0.050
Total Cluster B	2.000

Cluster C	
311 - reduce payroll costs related to improved scheduling of part time staffing	0.300
Fleet – reduced fuel costs	1.700
Total Cluster C	2.000
Total Divisions	6.300
Non-Program	
Tax Deficiencies (assessment appeals) Reduction	5.000
Payments in Lieu of Taxes	2.000
Parking Ticket Revenues	2.000
Total Non-Program	9.000
Agencies	
Police – possible reductions include reduced fuel costs, retained community safety grant, reduced sick bank contribution & other non-payroll expenditures	5.000
TTC – operating service improvements and related staffing adjustments, increased gapping, reduced WSIB contributions, reallocation of streetcar repairs to capital	5.000
Total Agencies	10.000
Total Budgetary Adjustments	25.300
Non-Program Capital From Current Offset	60.300
Total Toronto Pooling Compensation Loss Response	85.600

It should be noted that under section 39 (4) of the Police Services Act, the City, in establishing an overall budget for the board, does not have the authority to approve or disapprove specific items in the estimates. Accordingly it is recommended that the Board be directed to reduce their recommended budget by $5m and report back to Budget Committee for the February 20, 2015 meeting confirming the specific budget reduction measures it has approved.

These budget adjustments are designed to have no impact on 2015 service levels and reflect updated 2014 operating results.

DECISION HISTORY

At the January 29, 2015 meeting of the Budget Committee, a motion was passed (2015.BU3.4) requesting the City Manager and the Deputy City Manager & CFO to report to the February 13, 2015 meeting of the Budget Committee on the Social Housing Support Phase-out strategy including:

a. A short term financing strategy based upon the City's available financing authorities to deal with the revenue shortfall;

b. Options for funding the shortfall in 2015 and beyond through a phased strategy of budgetary adjustments, such phase-in strategies not to exceed 6 years (2015-2020); and

c. Options for funding the 2015 shortfall inclusive of budgetary adjustments related to City Divisions and Agencies.

ISSUE BACKGROUND

In 2008 the Province, in conjunction with changes resulting from the Provincial Municipal Fiscal and Service Delivery Review (PMFSDR), initiated the Toronto Pooling Compensation (TPC) grant program to compensate the City for the termination of GTA Equalization ("pooling") payments and Ontario Municipal Partnership Fund (OMPF) grants formerly provided by the Province to mitigate the disproportionate cost of downloaded social housing costs borne by the City.

In June 2013 the Province unexpectedly announced the phase-out of Toronto Pooling Compensation grants over three years, from 2014 to 2016, creating a $129 million annual revenue shortfall by 2016. In 2014 the City funded the first $43 million shortfall with one time sources. As a result, the 2015 shortfall is $86 million.

In 2013 City Council responded by requesting the Province rescind its decision to eliminate Toronto Pooling Compensation grants by 2016 or, at a minimum, maintain the social housing component of Toronto Pooling Compensation.

COMMENTS

The elimination of Toronto Pooling Compensation was announced in June 2013. In accordance with Council direction, staff had pursued a strategy of persuading the provincial government to reconsider this action. Since November of 2014, staff have been pursuing some form of compromise to delay the full elimination of the pooling funding to at least 2018. In January, given the Provincial rejection of delaying the full elimination, the strategy shifted, by necessity, to exploring ways to phase-in the impact to 2018 through reducing capital contributions, and financing the resulting capital funding shortfall on a short term basis.

The City considered a Provincial proposal for a loan (at full market terms), but determined that other means were available that would be more advantageous to the City, specifically bank loan financing. Subsequently, staff have identified an internal borrowing mechanism (from the City's investment pool) and are now recommending that approach.

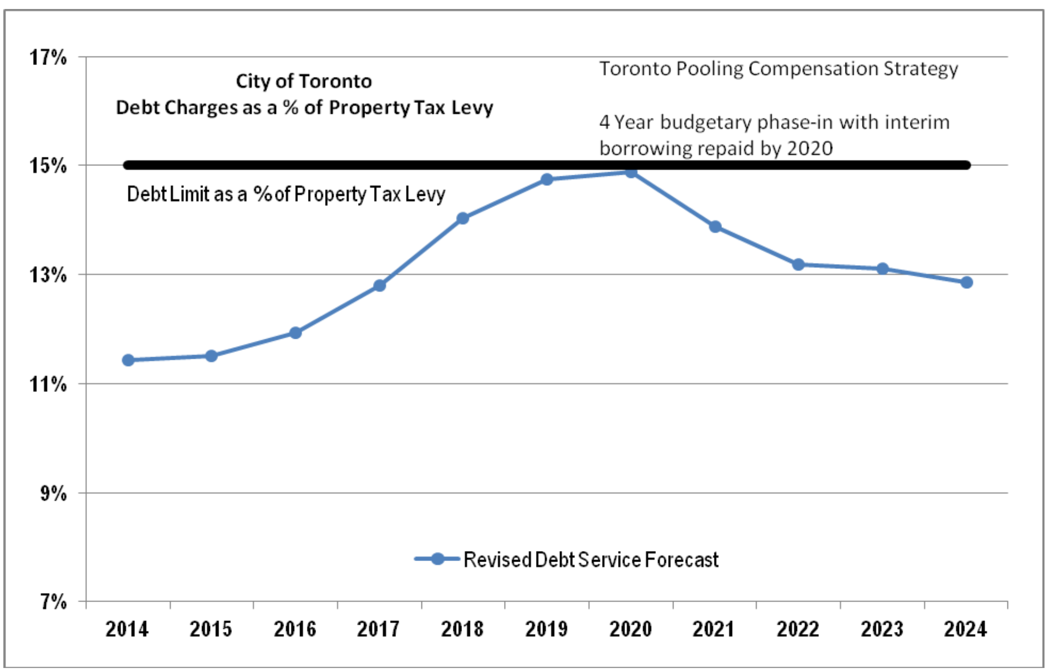
The key characteristics of the recommended phase-in are as follows:

1. Budgetary Phase-in Period – it is recommended that the budget be adjusted to fully address the TPC revenue loss over a period of 4 years. Longer term phase-ins were considered, but resulted in more short term borrowing (for capital). For example, if the budget phase-in is extended to 6 years, the amount of capital financing increases by approximately $35 million (i.e. from $130m to $165 m). In addition, the budget increases required to repay the debt are larger, increasing from 6.1% in aggregate, to 7.3% (see Appendix 2 and 3 for details). Four years is considered sufficient time to identify budget adjustments and minimize the need

for any associated tax increases. Finally, the recommended strategy deals with the full shortfall within this term of Council.

2. Debt repayment term – the recommended strategy would see the debt fully repaid within 6 years. This period is recommended in order to avoid encumbering the operating budget with the associated debt payments for an extended period. Constraining repayment to six years balances affordability of payments with maintaining longer term budget flexibility, takes advantage of current low short term borrowing costs, and completes all repayments prior to the City's peak projected debt service ratio in 2021. Once the debt has been repaid, a budget decrease of $46 million or about 1.6% could be considered in 2021. Staff would recommend that this decrease be used to increase the contribution from the operating fund to the capital fund (CFC) to minimize future debt charges and remain within the 15% debt service guideline.

3. Debt service ratio - the recommended strategy requires debt repayments of approximately $45 million per year from 2018 to 2020. These payments increase the City's debt service ratio over the period, just prior to the expected peak in the City's debt service ratio in 2021. Based on an updated debt service ratio forecast to reflect the current and forecasted low interest rate environment, the capital financing plan as recommended in this report is not expected to raise the debt service ratio above the Council adopted 15% limit, as shown below. Nevertheless, it is recommended that staff commence a detailed review of the City's capital requirements as part of the City's 2016 Capital Budget process, to ensure that debt affordability targets continue to be maintained, and report the results to Budget Committee early in the 2016 Budget process.



4. Internal borrowing mechanism - The least administratively burdensome and most flexible way to obtain the required financing is to borrow from internal sources. Under this approach, rather than accessing the capital markets or a bank, it is recommended that the City issue debt that is held by the City and held as an investment in its own investment portfolio. The City is permitted by regulation to invest in its own debt. The advantage of this approach is twofold – increased flexibility and lower costs. The transaction costs would be much less than a comparable syndicated market debenture issuance, and execution will be administratively simpler than a comparable bank loan. The City may also have some increased flexibility in structuring the debt so as best to suit the budgeting situation.

   The authorities for issuing debentures, and investing in City debt, are provided by the City of Toronto Act, 2006, Ontario Regulation 610/2006, Chapter 30 of the Municipal Code, and the City's Investment Policy. The Deputy City Manager & Chief Financial Officer is required to report annually to Council on all debt issuance and investment activity which has occurred in the year.

CONTACT

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SIGNATURE

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ATTACHMENTS:

Appendices 1A and 1B – Financial Implications

Appendix 2 – Summary of 4 year Budgetary Adjustments and Capital Financing Plan

Appendix 3 – Illustration of 6 Year Budgetary Adjustments and Capital Financing Plan

Appendix 1A
Financial Implications

2015 Budget Adjustments

In order to absorb the housing impact in 2015, staff recommend reducing the 2015 Staff Recommended Operating Budgets by a total of $32.033 million gross and $25.3 million net for the following City Programs and Agencies, subject to confirmation by the TTC and Police Services Board for those agencies:

Program	Description	Gross $M	Net $M	Position
Cluster A - $2.3M				
Toronto Employment & Social Services	• Reduction of average monthly caseload by 1,500 (95,000 to 93,500) based on 2014 projected actual caseload	13.833	1.650	-16
Shelter, Support & Housing Administration	• Reduction in non-TCHC mortgage renewals due to lower interest rates	0.500	0.500	
Children's Services	• Fewer part-time hours required for the directly operated programs as a result of the implementation of full day kindergarten.	0.150	0.150	
Cluster B - $2.0M				
Transportation Services	• Reduce 5 vacant positions since 2012 ($0.425M) • Increase parking permit revenues based on 2014 accounts ($0.868M) • Re-allocation of funding of 2 positions related to the Public Realm Program ($0.229M)	1.522	1.522	-5
Fire Services	• Reduction in materials, supplies and equipment expenses based on 2014 projected actual expenditures	0.300	0.300	
Policy, Planning, Finance and Administration	• Reduction in various non-salary accounts based on 2014 projected actual expenditures	0.128	0.128	
Engineering & Construction Services	• Reduction in contracted services for office space adjustments	0.050	0.050	
Cluster C - $2.0M				
Fleet Services 311 Toronto	• Reduction of $1.7M due to update of lower fuel costs. • Lower payroll costs due to improved scheduling of part-time staffing	1.700 0.300	1.700 0.300	

Program	Description	Gross $M	Net $M	Position
Non-Program – 9.0M				
Expenditures	• Tax deficiencies reduction of $5.0M to reflect 2014 projected actual expenditures	5.000	5.000	
Revenues	• Payment in lieu of taxes – increase of $2.0M to reflect 2014 projected actuals • Parking ticket revenues – increase of $2.0M to reflect 2014 projected actuals		4.000	
City Total		**22.033**	**15.300**	**-21**

Appendix 1B
Financial Implications

It should be noted that under section 39 (4) of the Police Services Act, the City, in establishing an overall budget for the board, does not have the authority to approve or disapprove specific items in the estimates. Accordingly it is recommended that the Board be directed to reduce their recommended budget by $5m and report back to Budget Committee for the February 20, 2015 meeting confirming the specific budget reduction measures it has approved.

Program	Description	Gross $M	Net $M	Position
Toronto Police Service	• Reduction in fuel costs based on current fuel prices • Increase in Safer Communities Policing Grant to maintain 2014 funding level • Reduction in contribution to sick pay reserve • Reduction in non-payroll expenditures based on 2014 experience	5.000	5.000	
Toronto Transit Commission	• WSIB – reduced by $0.6M due to lower than anticipated payouts • Gapping - increase of 0.4% (2.6% to 3.0%) to reflect anticipated staffing levels with savings of $1.0M • New operating service improvements – reduction of 40 positions ($2.0m) • Reallocate costs for streetcar road infrastructure appropriately to the Capital Budget ($1.4M)	5.000	5.000	-40
Agency Total		10.000	10.000	-40

Appendix 2
Summary of Budgetary Adjustments and Capital Financing Plan

Recommended 4 yr Phase-in

Year	2015	2016	2017	2018	2019	2020	2021
Original TPC schedule	$135.6	$128.8	$121.9	$115.1	$115.1	$115.1	$115.1
TPC Elimination schedule	$50.0	0	0	0	0	0	0
Revenue Loss	$85.6	$128.8	$121.9	$115.1	$115.1	$115.1	$115.1
Recommended Cumulative Budgetary Adjustments	$25.3	$69.3	$114.5	$160.6	$160.6	$160.6	$115.1
Equivalent Residential Tax Increases	1.0%	1.7%	1.7%	1.7%	-	-	-1.6%
Cumulative Equivalent Residential Tax Increases	1.0%	2.7%	4.4%	6.1%	6.1%	6.1%	4.5%
Year	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Borrowing	$60.3	$59.5	$7.5	-	-	-	-
Short Term Interest @1.5%	-	$0.9	$1.8	$3.3	$2.2	$1.1	-
Debt Charges	-	-	-	$45.5	$45.5	$45.5	-
Net Amount Owing	$60.3	$120.7	$130.0	$87.7	$44.4	$0.0	-
Year	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
CFC Budget	$258.7	$198.4	$225.1	$305.6	$344.4	$378.8	$416.7
CFC Reduction (Incremental Impact)	($60.3)	$0.8	$52.0	$7.5	-	-	-
CFC Budget Growth		$25.9	$28.5	$31.3	$34.4	$37.9	$41.7
Revised CFC	$198.4	$225.1	$305.6	$344.4	$378.8	$416.7	$458.4

Appendix 3

Illustration of Budgetary Adjustments and Capital Financing Plan

6 year Budgetary Phase-in

Year	2015	2016	2017	2018	2019	2020	2021	2022
Original TPC schedule	$135.6	$128.8	$121.9	$115.1	$115.1	$115.1	$115.1	
TPC Elimination schedule	$50.0	0	0	0	0	0	0	
Revenue Loss	$85.6	$128.8	$121.9	$115.1	$115.1	$115.1	$115.1	
Recommended Cumulative Budgetary Adjustments	$25.3	$57.7	$90.9	$125.0	$159.9	$195.7	$157.1	$115.1
Equivalent Residential Tax Increases	1.0%	1.25%	1.25%	1.25%	1.25%	1.25%	-1.32%	-1.40%
Cumulative Equivalent Residential Tax Increases	1.0%	2.25%	3.5%	4.75%	6.0%	7.25%	5.88%	4.50%
Year	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Borrowing	$60.3	$71.1	$31.0	-	-	-	-	-
Short Term Interest @1.5%	-	$0.9	$2.0	$4.1	$4.0	$3.0	$1.0	$0.0
Debt Charges	-	-	-	$9.9	$44.8	$80.6	$42.0	$0.0
Net Amount Owing	$60.3	$132.3	$165.2	$159.5	$118.6	$41.0	-	-
Year	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
CFC Budget	$258.7	$198.4	$213.5	$282.1	$344.4	$378.8	$416.7	$458.4
CFC Reduction (Incremental Impact)	($60.3)	($10.8)	$40.1	$31.0	-	-	-	-
CFC Budget Growth		$25.9	$28.5	$31.3	$34.4	$37.9	$41.7	$45.8
Revised CFC	$198.4	$213.5	$282.1	$344.4	$378.8	$416.7	$458.4	$504.2