



## STAFF REPORT ACTION REQUIRED

### Provincial Amalgamation Loans

<b>Date:</b>	July 3, 2013
<b>To:</b>	City Council
<b>From:</b>	Deputy City Manager and Chief Financial Officer
<b>Wards:</b>	All
<b>Reference Number:</b>	P:\2013\Internal Services\acc\cc13012acc (AFS17921)

#### **SUMMARY**

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This report provides information related to the provincial loans provided to the City in 1998 and 1999 for the purpose of amalgamation, the status of those loans, as well the implications associated with the Province's recent decision to forgive the outstanding balance of the loans over a three-year time period (2014 to 2016).

On an accounting basis, following generally accepted accounting principles, the liability for the loan balance and accrued interest will be eliminated as the Province advises that the loan is no longer payable. Accounting allows for professional judgement and is guided by the terms and conditions of any provincial agreement.

Once complete, the forgiveness of the loan will lower the City's outstanding debt by \$170 million. Accrued interest expense of \$42 million will be cancelled and can be taken into revenue for future budgets. There are no ongoing benefits to the City's operating budget beyond the elimination of the related \$4.7 million annual debt charge provision in 2014.

#### **RECOMMENDATION**

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**The Deputy City Manager and Chief Financial Officer recommends that:**

1. City Council receive this report for information.

#### **Financial Impact**

As at December 31, 2012, the City's financial records include an existing liability owed to the Province of \$170,171,126 (representing the loan balance outstanding) plus accrued

interest of \$36,982,396 (total liability of \$207.2 million). By the end of 2013, the accrued interest will total \$41,680,820 (total liability of \$211.9 million).

On June 13, 2013, the Province advised the City that it will forgive the balance of the outstanding loan over a three-year time frame beginning in 2014. Given that the City's 2013 approved operating budget includes an amount equivalent to the accrued interest on the outstanding loan balance to 2013, the forgiveness of the loan beginning in 2014 will result in one-time revenue of \$41,680,820 in 2014. Additionally, the City will no longer be required to budget annual interest charges of \$4.7 million on the outstanding loan balance beginning in 2014. The allocation of the one-time revenue and the removal of the budgetary expense associated with the \$4.7 million annual interest that is no longer required, will be included as part of the 2014 budget process. At the same time, the Province has indicated that it will be eliminating Toronto Pooling Compensation (TPC). From a budget perspective, there is no gain associated with the outstanding principal loan balance of \$170,171,726 as payment for this amount has not been included in the City's approved budget since 2006.

Strategies or options will need to be developed to help offset the budgetary revenue loss (\$149.3 million) of the TPC grant. A companion report outlines the implications of the TPC revenue loss to the City's Social Housing and Employment and Social Services.

The Deputy City Manager and Chief Financial Officer has reviewed this report and agrees with the financial impact information.

## **DECISION HISTORY**

Two interest-free loans of \$100 million each were provided by the Province in 1998 and 1999 to assist the City in financing various capital costs associated with amalgamation and transition and were included in the City's 1998 and 1999 capital budgets. The loans had a repayment term of 5 and 4 years, respectively. However, the loans' repayment terms required the City to make large payments that we were not able to fully fund from the City's 2002 to 2004 operating budgets. In order to deal with this situation, the City requested the Province to renegotiate the loans so that payments would be amortized over a 10 year term and become more affordable.

At its meeting held on July 22 - 24, 2003, City Council adopted a Notice of Motion that authorized the issuance of a 3.00 percent per annum debenture for \$183,750,000 to mature on January 15, 2014 to the Province of Ontario to facilitate the restructuring of the provincial amalgamation loans. By-law 864-2003, enacted on September 24, 2003, authorized the issuance of the debenture.

<http://www.toronto.ca/legdocs/2003/agendas/council/cc030722/cofa.pdf>

At its meeting held on June 22 - 24, 2004, City Council:

- authorized the issuance of a 2.761 percent per annum debenture for \$175,330,772.70 to mature on January 15, 2014 to the Province of Ontario in

order to facilitate the deferral of the 2004 payment of \$20 million in respect of the 2003 debenture. By-law 462-2004, enacted on June 22, 2004, authorized the issuance of the debenture; and,

- in agreeing to the restructuring of the provincial loan, reiterated to the Province its position that the loan should be forgiven, recognizing its inequitable cost allocation resulting from amalgamation as identified by the Provincial Auditor.

(re: Policy and Finance Committee Report 5, Clause 5 title "Restructuring of the Provincial Loan, \$20 Million Payment Deferral for 2004").

<http://www.toronto.ca/legdocs/2004/agendas/council/cc040622/pof5rpt/cl005.pdf>

At its meeting held on March 29 and 30, 2006 City Council approved a reduction of \$20 million to the 2006 Budget Advisory Committee Recommended Capital and Corporate Financing Budget based upon an agreement to defer the 2006 Provincial loan repayment installment and continuing discussions with the Province on the remaining balance of the loan (re: Policy and Finance Committee Report 2, Clause 1 titled "City of Toronto 2006 Budget Advisory Committee Recommended Tax Supported Operating Budget", motion A4).

<http://www.toronto.ca/legdocs/2006/agendas/council/cc060329/cl001.pdf>

## ISSUE BACKGROUND

In each of 1998 and 1999, the Province provided the City with \$100 million interest free loans and a \$50 million grant to assist with amalgamation. Quarterly payment schedules with respect to the loans were negotiated to begin on March 31, 2001 as follows:

**Table 1: Original Loan Repayment Schedule**

	Mar 31	June 30	Sept 30	Dec 31	Total
	(\$ millions)				
2001	5.00	3.75	3.75	3.75	16.25
2002	16.25	15.00	15.00	15.00	61.25
2003	57.5	0	0	0	57.5
2004	65.00	0	0	0	65.0
<b>TOTAL</b>					<b>200.0</b>

During 2001, the City remitted payments to the Province totalling \$16.25 million, bringing the outstanding balance to \$183,750,000 (\$200 million - \$16.25 million).

In 2003, the loan agreement was re-structured at an interest rate of 3% compounded semi-annually and an 11 year amortization period (2003 to 2014), with payment occurring semi-annually on July 15 and January 15 of each year. A blended interest / principal payment of \$10 million biannually was required under the Council approved amortization schedule.

In 2003, the City paid the Province one blended payment of \$10 million (\$8,419,227 principal + \$1,580,773 interest), bringing the outstanding principal loan balance to \$175,330,773 (\$183,750,000 - \$8,419,227).

In 2004, the loan was renegotiated to facilitate the deferral of the 2004 payments of \$20 million on an interest-free basis in respect of the 2003 debenture. The new loan agreement was restructured at an:

- interest rate of 2.761% compounded semi-annually (and reflecting the deferral of \$20 million); and,
- amortization period of nine and a half years (January 2005 to January 2014), with payments occurring semi-annually on July 15 and January 15 of each year.

Attached as Appendix A is the repayment schedule approved by City Council at its meeting in June 2004. A blended interest / principal payment of \$10 million semi-annually was required under the schedule.

In January 2005, the City remitted to the Province the first payment of \$10 million (\$5,159,647 principal + \$4,840,353 interest) under the approved amortization schedule, bringing the outstanding principal loan balance to \$170,171,126 (\$175,330,775 - \$5,159,647).

Table 2, below, summarizes the loans received from the Province in 1998 and 1999, and the repayments to 2005. No further payments have been made by the City with respect to these loans since January 2005.

**Table 2: Loan Receipt and Repayment History**

<b>Date</b>	<b>Description</b>	<b>\$ Amount</b>	<b>Outstanding Loan Balance (Principal)</b>
1998	Interest-free loan advance	100,000,000	100,000,000
1999	Interest-free loan advance	100,000,000	200,000,000
2001	Repayment	(16,250,000)	183,750,000
2003	Repayment	(8,419,227)	175,330,773
2005	Principal portion of \$10 million repayment Jan 15, 2005	(5,159,647)	170,171,126

The loan agreement with the Province included a provision for allowing property owned by the City, if deemed suitable by the Province, to be transferred to the Province to offset a portion of the amounts owing. Given a decision by the Province in 2005 to not permit a further \$20 million loan payment deferral for 2005, City staff entered into negotiations with Provincial staff to determine whether any City surplus properties could be transferred in satisfaction of amounts owing.

In 2006, the Province agreed to defer the 2006 Provincial loan repayment instalment. Based on this agreement, City Council approved a reduction of \$20 million to the 2006 Approved Operating Budget. Since that time, discussions continued with the Province on

the remaining balance of the loan, possible property transfers to satisfy the loan, and Council's repeated request that the loan be forgiven in light of the continuing fiscal challenges related to Local Services Re-alignment (which, in Toronto, occurred concurrently with amalgamation), and the inequitable allocation of amalgamation transition assistance compared to other Ontario amalgamated municipalities.

In 2007, the Province (in a letter dated May 14, 2007 from the Deputy Minister of Finance to the City Manager) advised the City that the Province has allowed for the non collection of the loan. At no time since 2007 has the Province requested or demanded repayment. Also since 2007, the Province has never invoiced the City for any repayments. In fact it was City staff's understanding that the Province did not expect repayment of the loan. Based on this understanding, no further principal loan repayment amounts were included in the City's approved budgets after 2006.

Since 2007, the outstanding loans have been treated as interest-bearing, with no fixed repayment. No amount for the repayment of the outstanding loan principal has been included in the City's operating budget based upon an understanding and expectation that the loan would be either satisfied through a transfer of surplus properties or forgiven. However, the City's annual operating budget continues to include an amount of approximately \$4.7 million per year in debt servicing costs representing interest only on the loan at 2.761%. Applicable interest continues to be included in the City's budget given that it was not clear if the Province would treat accrued interest in the same manner as the principal. As such, interest continued to be budgeted for on an annual basis in case the Province requested payment of the accrued interest on the loans.

### **Provincial Support Provided to Other Amalgamating Municipalities**

Based on a review of the four largest amalgamating municipalities (Toronto, Ottawa, Hamilton and Sudbury), it is staff's understanding that all other urban municipalities that went through an amalgamation in 2001 received provincial grants in support of transition costs (not loans). Toronto is the only amalgamating municipality that was originally expected to repay the Province for its transition support. Although Toronto did receive a grant of \$50 million in 1998, it was not tied to transition cost and on a per capita basis was well below the level of provincial support provided to other urban municipalities. As indicated in Table 3 below, even if you include a \$50 million benefit based on an interest free loan, the level of support provided to Toronto on a per capita basis is substantially below that provided to Ottawa (the closest comparator), as well as being below Hamilton and Sudbury.

**Table 3: Comparison of Provincial Support**

<b>Municipality</b>	<b>Provincial Support (\$M)</b>	<b>Provincial Support (\$ per capita)</b>	<b>Comments</b>
Toronto – after decision to forgive loan	\$215	\$95	\$50M grant + \$200M loan less \$35M repayments made to date
Ottawa	\$108.5 grant	\$151	50% of transition costs plus interest to borrow the other 50%
Hamilton	\$56.5 grant	\$68	(50% of transition costs plus 2 years interest to borrow the other 50%) + \$25M grant in respect of 1999 restructuring
Sudbury	\$19.2 grant	\$64	(50% of transition costs plus 2 years interest to borrow the other 50%) + \$4.1M grant

After the Toronto loan is forgiven, and effectively turned into a "grant" and after factoring in repayments made to date, the level of "grant" assistance Toronto would have received (\$215 M or \$95 per capita) is relatively less than what Ottawa received.

Accordingly, Toronto's position is that the \$200 million in amalgamation loans should always have been grants. By forgiving these outstanding loans the Province is simply correcting an inequity and treating Toronto the same that it treated other urban amalgamating municipalities.

## **COMMENTS**

### **Provincial Loan Write-off**

In a letter dated June 13, 2013 to Mayor Ford from Minister Sousa, the Province advises that it will write-off the City's outstanding loan over three years (2014 to 2016 inclusive), thus providing the City "with a financial benefit of over \$230 million by 2016".

The Province values the loan at \$231.3 million (principal \$170.2 million + \$60.1 million in accrued interest to 2016). In calculating the accrued interest, the Province compounded interest for missed payments and assumed that remissions only occur at the end of each year.

The City has valued the loan at its face value of \$170,171,726, plus accrued interest as at December 31, 2013 of \$41,680,820. Given that the province has indicated their plan to forgive the loan over 2014 through 2016, the City will no longer accrue interest after

2013. As a result, there is a difference of approximately \$19.5 million between the City's value of the loan forgiveness (\$211.8M) and the amount shown by the province (\$231.3M). As the province allowed for non-collection of the loan in their 2005-2006 fiscal year, it has not been accruing any interest on the loan since that time. As such, no matter what value the Province places on the loan, it will not affect their financial surplus or deficit.

On an annual basis, the City's external auditors have confirmed the loan with the Ministry of Municipal Affairs and Housing. It must be emphasized that this does not constitute a request for payment; it is an accounting matter, required for preparation of the City's financial statements.

### **Provincial Loan Impact on City's Operating Budget**

Given that the City's 2013 approved operating budget includes an amount equivalent to the accrued interest on the outstanding loan balance to 2013, the forgiveness of the loan beginning in 2014 will result in a one-time revenue of \$41,680,820 in 2014. Additionally, the City will no longer be required to budget annual interest charges of \$4.7 million on the outstanding loan balance beginning in 2014.

The allocation of the one-time surplus of \$41.7 million and the budgeted expense associated with the \$4.7 million annual interest that is no longer required, will be included and discussed as part of the 2014 budget process. From a budget perspective, there is no gain associated with the outstanding principal loan balance of \$170,171,726 as payment for this amount has not been included in the City's approved budget since 2006.

Prior to the 2014 operating budget process, City staff will assess options on how best to account for the one-time surplus of \$41.7 million. Options include:

1. recognizing a one-time gain of \$41.7 million in the 2014 budget;
2. placing some monies in a reserve and recognizing the revenue over the three year period as the loan is forgiven; or,
3. recognizing the one-time revenue in 2016, once the province has advised that the forgiveness is complete.

### **Impact on City's Financial Statements**

On an accounting basis, following generally accepted accounting principles, the liability for the loan balance and accrued interest will be eliminated as the Province advises that the loan is no longer payable. Accounting allows for professional judgement and is guided by the terms and conditions of any provincial agreement.

Over the three year period (2014 to 2016), the City will record an "accounting" gain of \$211,851,946 (\$170,171,726 plus accrued interest of \$41,680,820). It is anticipated that the Province, in each of the three years (2014 to 2016), will confirm the amount that it

has written-off in that year. The City will then record that share of the loan forgiveness, plus associated interest, as an "accounting gain".

Once complete, the forgiveness of the loan will lower the City's outstanding debt by \$170.2 million and lower the capital financing (debt charges) budget by \$4.7 million annually. There are no other ongoing (i.e. annual) benefits to the City's budget beyond the \$4.7 million debt charge reduction from forgiving the provincial loans.

## **CONTACT**

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## **SIGNATURE**

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Roberto Rossini  
Deputy City Manager and  
Chief Financial Officer

## **ATTACHMENTS**

Appendix A: Loan Amortization Schedule Approved by City Council (June 2004)



## Appendix A

### Loan Amortization Schedule Approved by City Council (June 2004)

#### SCHEDULE "A"

#### DEBENTURE PAYMENT AMOUNTS

(INCLUDING BREAKDOWN OF PRINCIPAL AND INTEREST, AND BALANCES)

Outstanding amount as at the date of the Agreement - \$175,330,772.70

Due Date	Payment Amount	Interest	Principal	Balance O/S
15-Jan-2005	\$ 10,000,000.00	\$ 4,840,352.59	\$ 5,159,647.41	\$ 170,171,125.29
15-Jul-2005	\$ 10,000,000.00	\$ 2,329,648.68	\$ 7,670,351.32	\$ 162,500,773.97
15-Jan-2006	\$ 10,000,000.00	\$ 2,261,513.81	\$ 7,738,486.19	\$ 154,762,287.77
15-Jul-2006	\$ 10,000,000.00	\$ 2,118,701.15	\$ 7,881,298.85	\$ 146,880,988.93
15-Jan-2007	\$ 10,000,000.00	\$ 2,044,134.17	\$ 7,955,865.83	\$ 138,925,123.09
15-Jul-2007	\$ 10,000,000.00	\$ 1,901,889.81	\$ 8,098,110.19	\$ 130,827,012.91
15-Jan-2008	\$ 10,000,000.00	\$ 1,820,711.92	\$ 8,179,288.08	\$ 122,647,724.83
15-Jul-2008	\$ 10,000,000.00	\$ 1,679,051.66	\$ 8,320,948.34	\$ 114,326,776.49
15-Jan-2009	\$ 10,000,000.00	\$ 1,591,079.09	\$ 8,408,920.91	\$ 105,917,855.58
15-Jul-2009	\$ 10,000,000.00	\$ 1,450,019.16	\$ 8,549,980.84	\$ 97,367,874.74
15-Jan-2010	\$ 10,000,000.00	\$ 1,355,063.04	\$ 8,644,936.96	\$ 88,722,937.78
15-Jul-2010	\$ 10,000,000.00	\$ 1,214,620.13	\$ 8,785,379.87	\$ 79,937,557.91
15-Jan-2011	\$ 10,000,000.00	\$ 1,112,486.34	\$ 8,887,513.66	\$ 71,050,044.25
15-Jul-2011	\$ 10,000,000.00	\$ 972,677.60	\$ 9,027,322.40	\$ 62,022,721.85
15-Jan-2012	\$ 10,000,000.00	\$ 863,166.61	\$ 9,136,833.39	\$ 52,885,888.46
15-Jul-2012	\$ 10,000,000.00	\$ 724,009.67	\$ 9,275,990.33	\$ 43,609,898.13
15-Jan-2013	\$ 10,000,000.00	\$ 606,916.41	\$ 9,393,083.59	\$ 34,216,814.54
15-Jul-2013	\$ 10,000,000.00	\$ 468,429.39	\$ 9,531,570.61	\$ 24,685,243.93
15-Jan-2014	\$ 25,028,787.03	\$ 343,543.10	\$ 24,685,243.93	\$ 0.00
<b>Total</b>	<b>\$ 205,028,787.03</b>	<b>\$ 29,698,014.33</b>	<b>\$ 175,330,772.70</b>	