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2015 CAPITAL/OPERATING BUDGET BRIEFING NOTE

Water Rate Increases and Economic Competitiveness

Issue:

- At its meeting of January 26, 2015, the Budget Committee requested *"that the General Manager, Economic Development and Culture and the General Manager, Toronto Water, provide a briefing note highlighting the impacts of a water rate increase to major, large industrial employers and the economic competitiveness and economic development rationale to lowering the water rate."*
- Toronto Water in its 2015 Operating Budget submission proposes an 8% increase in the water rate, effective March 13th, including Block 2 users, for both 2015 and 2016.
- At its meeting on December 16, 17 and 18, 2013, Toronto City Council adopted the amended staff report titled "2014 Water and Wastewater Rates and Service Fees" which included the following recommendation number (9) *"City Council request the General Manager, Toronto Water to give consideration in 2015 and future years' Toronto Water budgets to limiting Block 2 Customer water rate increases to a 3% rate increase, or a rate tied to the inflation rate, as a mechanism to use water as an economic driver to support business competitiveness in Toronto."*
- The Block 2 rate was introduced to address concerns about improving the competitive economy in Toronto and to ensure that economies of scale for large water users were addressed, providing those industrial businesses who qualify with a 30% reduction compared to the Block 1 rate (for general consumption). It was also implemented to recognize that industrial process needs for water are different than domestic needs. Currently, 126 large industrial businesses participate in the Block 2 program. Since 2008, this has resulted in a savings of over \$85 million to Toronto's Industrial Block 2 customers. Toronto Water's revenue during that time was nearly \$308 million from Block 2 customers.

Table 1: Block 2 Water Rate Savings

	2008	2009	2010	2011	2012	2013	2014	2008-2014
Block 1 Rate, \$/m ³	\$1.74	\$1.89	\$2.06	\$2.28	\$2.49	\$2.71	\$2.96	
Block 2 Rate, \$/m ³	\$1.39	\$1.43	\$1.47	\$1.60	\$1.74	\$1.90	\$2.07	
Difference	\$0.35	\$0.46	\$0.59	\$0.69	\$0.75	\$0.81	\$0.89	
Block 2 Discount %	20%	24%	29%	30%	30%	30%	30%	
Total Savings, \$millions	\$8.27	\$8.07	\$10.14	\$15.41	\$13.50	\$14.64	\$15.79	\$85.83
Block 2 Revenue, \$millions	\$33.08	\$25.55	\$24.82	\$35.95	\$31.50	\$34.16	\$36.84	\$221.90

Source: City of Toronto, Corporate Finance, Financial Policy

- A benefit that the City receives in return for offering a Block 2 discount is that users must meet the terms of specific provisions relating to water conservation and compliance with the Sewer Use By-Law. Maintaining a competitive Block 2 rate will encourage more firms to participate.
- Toronto Water will be submitting a report to the Executive Committee in the Spring 2015 which will discuss a separate funding structure for stormwater management. If approved, Toronto's large industrial water customers will see significant additional cost reductions in their water bill, however, such relief is, at minimum, two years away.

Key Points:

- Many industrial employers in Toronto use large volumes of city water which is essential to their product and/or core product processes. The cost of water and other operating costs relative to competitive markets and locations throughout North America is an important business concern particularly for large water users. Some examples are provided below as found in media and staff reports.
 - Other Ontario municipal planned increases for 2015 - Hamilton 4.2%, Durham 5%, Brockville 3.5%, Guelph 4.1%, Waterloo 5%.
 - U.S. planned increases for 2015 - New York City 3.35%, Chicago 3.98%, Columbus 3%.
- Toronto's water costs for industrial users are becoming less competitive and place the viability of Toronto-based operations at risk. Any increase to the cost of business will impact Toronto's competitiveness in attracting and retaining business investment.
- The loss of just one of the top 5 large industrial Block 2 water user would result in an average annual loss of over \$2.0 million in water revenue to the City and the loss of around 500 jobs, in addition to the residual impact of such a closure on the community.
- An 8% rate increase is being recommended in the proposed 2015 Operating Budget for adoption by City Council at its meeting in March 2015.
 - Note: 2014 water and wastewater consumption rates remain in effect until amended in March, making the actual annualized water consumption rate increase for 2015 6.5%.
- The impact of the proposed water rate increase (8%) on residential, industrial and commercial users at 'typical consumption' is illustrated in the table below along with alternative Block 2 rate increases of 3%, 4% and 5%. Each 1% decrease from the proposed Block 2 rate change of 8% results in a \$300,000 loss in revenue to Toronto Water that will need to either be absorbed by other rate payers in 2015 or be offset through reductions to the Toronto Water 10-Year Capital Plan.
- At 8%, the rate increase business impact on a Block 2 consumer of 1,000,000 m³ of water will be an additional \$134,218, increasing the annual water cost to a large industrial employer to more than \$2.2 million in 2015.
- As illustrated in the table below, lowering the Block 2 rate increase has minimal impact on residential and other Block 1 users.

- A 3% Block 2 rate increase would result in a Block 1 increase of 8.2% instead of 8.0%, adding another \$1.34 to a residential consumer of 280m³ for a total rate impact of \$54.89 and adding another \$500 to a commercial consumer of 100,000 m³ for a total rate impact of \$19,603.
- A 4% Block 2 rate increase would result in Block 1 increase of 8.16% instead of 8.0%, adding another \$1.07 to the residential consumer for a total increase of \$54.62 and adding another \$400 to the commercial consumer for a total increase of \$19,508. A 5% Block 2 rate increase would result in Block 1 increase of 8.12% instead of 8.0%, adding \$0.80 to the residential consumer for a total increase of \$54.35 and adding less than \$300 to the commercial consumer for a total increase of \$19,412.

Table 2: Impact of 8% Increase vs. 3%, 4% and 5% Rate Increase to Water Users Implemented on March 13, 2015

Property Type	Typical Use (m ³)	2014 Cost	2015 Rate Increase Impact*							
			8% annualized increase to Block 2 (8% Block 1)^		3% annualized increase to Block 2 (8.2% Block 1)^		4% annualized increase to Block 2 (8.16% Block 1)^		5% annualized increase to Block 2 (8.12% Block 1)^	
Residential	280	\$828	\$53.55	6.5%	\$54.89	6.63%	\$54.62	6.60%	\$54.35	6.56%
Commercial (Block 1)	100,000	\$295,790	\$19,125	6.5%	\$19,603	6.63%	\$19,508	6.60%	\$19,412	6.56%
Industrial (Block 2)	100,000	\$212,374	\$13,732	6.5%	\$5,895	2.78%	\$7,463	3.51%	\$9,030	4.25%
Large Industrial (Block 2)	1,000,000	\$2,075,824	\$134,218	6.5%	\$51,078	2.46%	\$67,706	3.26%	\$84,334	4.06%

*Rates are annualized for 2015 to take into account the March 13, 2015 effective date.

^Non-annualized rate increase.

Source: City of Toronto, Corporate Finance, Financial Policy

- Toronto's 2014 water rate for large industrial users falls within the middle range compared to 905 municipalities, as shown in the table below.

Table 3: Comparison of Water Costs (2014) for Large Industrial Users in GTA at 1.0 million m³/year

Region	2014 Cost (millions)
Durham	\$1.869
Peel	\$1.894
Halton	\$2.069
Toronto	\$2.076
Hamilton	\$2.627
Vaughan	\$3.086
Markham	\$3.065
Richmond Hill	\$3.140

Note Does not include any sewer rebates for Toronto or the 905 municipalities

Source: City of Toronto, Corporate Finance, Financial Policy

- Comparisons to costs after sewer rebates (situations where the water does not enter the sewage stream such as for operations that bottle City water) are difficult to compile since each jurisdiction handles this in a different manner.

- Strengthening support for retaining and expanding industry as a strategy to boost business growth in Toronto supports a number of objectives of *Collaborating for Competitiveness Economic Growth and Job Creation Strategy* adopted by Council in February 2013, and remains important to creating balanced and sustained economic growth.
- Toronto has a goal to add 35,000 new jobs per year. In order to accomplish this, economic development investment and retention tools at the City's disposal need to remain competitive compared to other jurisdictions.
- Toronto City Council also adopted the Enhancing Toronto's Business Climate initiative in 2005, which has and continues to result in business tax reductions. However, industrial taxpayers still pay almost 3 times per dollar of assessment than residential and much higher rates than in the 905 and other competitive jurisdictions.
- Business tax reductions are accomplished by limiting tax rate increases on business to one-third of any tax rate increase on residential, as well as by a reduction in tax ratios for the business classes. Since 2008, this has resulted in a tax savings to Toronto's Industrial class of over \$30 million.

Table 4: Property Tax Policy Impact on Industrial Tax Class

Million, \$	2008	2009	2010	2011	2012	2013	2014	2008 - 2014
Savings from 1/3 Rate Increase Limit	\$3.03	\$3.51	\$2.55	\$0.00	\$2.16	\$1.69	\$1.83	\$14.77
Savings from Tax Ratio Policy	\$5.78	\$2.79	\$3.12	\$4.67	\$0.31	-\$0.37	-\$0.56	\$15.74
Total Savings	\$8.81	\$6.30	\$5.68	\$4.67	\$2.47	\$1.32	\$1.27	\$30.51

Background

- A significant number of manufacturing companies use City water as an essential part of their product and/or core product processes. For industrial manufacturers and core process users of water, the cost of water will have a direct effect on their existing and future competitiveness.
- While manufacturing employment in Toronto, and elsewhere, has declined over the past few decades for a number of economic and structural reasons, it remains a critical component of Toronto's economy, employing more than 114,000 people (about 9% of total jobs in the city). The manufacturing industry's economic impact continues to outweigh direct employment due to increases in productivity.
- In competing with other jurisdictions, Toronto manufacturers face significant challenges stemming from operating in a high-density urban environment, including rising land values and operational costs, urban growth pressures, encroachment from sensitive uses, traffic congestion, older building stock and comparatively higher property taxes.
- The City competes on different levels when it comes to the industrial/manufacturing sector. Locally the City competes with the surrounding 905 municipalities that have lower property taxes and comparable service fees, but can boast new industrial properties designed to accommodate modern manufacturing operations. At the North American level, the City is competing with industrial regions with lower cost dynamics and manufacturing capacity to absorb Toronto operations with global mandates.

- Many large industrial operations located in Toronto are subsidiaries of foreign parent companies, predominately U.S. corporations. In many cases the decision to stay in Toronto is made at the corporate head office located in other jurisdictions. Toronto based operations must compete with "sister" locations for global product mandates and new product lines; elements of these competitions are directly related to costs, regulatory considerations and the ability to quickly expand an existing facility.
- Recent economic trends indicate that manufacturing activity is returning to the GTA and it is important that the City remain competitive in order to capture a share of the increasing manufacturing activity.

Questions & Answers

Q: Job creation and investment attraction are key priorities for the City, how does increasing Toronto water rates relate to this economic priority?

A: If the City's priority is to foster job creation and attract new business investments then increasing business costs sends the opposite message to potential employers.

Q: Can you give examples of Block 2 Customers that will be affected by this increase?

A: An increase in water rate would impact businesses such as Irving Tissue, Atlantic Packaging, Nestle, Campbell's Soup, Sanofi Pasteur, Owens Corning and Bombardier.

Q: What are examples of manufacturing processes that require large volumes of water?

A: Food processing companies are the biggest consumers of water; from being a key product component, in product processing, to cooking to cleaning. Other key sectors include pharmaceuticals, injection moulding, machine and equipment manufacturers, metal plating, ready mix cement companies, energy and process steam producers.

Q: Why are some large industrial water users not currently participating in the Block 2 program?

A: We have not surveyed the non-users but anecdotal information points to a wish to avoid administrative processes and possible costs to meet the criteria.

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