



STAFF REPORT ACTION REQUIRED

The City of Toronto's long-term financial direction

Date:	May 16, 2016
To:	Executive Committee
From:	City Manager Deputy City Manager & Chief Financial Officer Deputy City Manager – Cluster A Deputy City Manager – Cluster B
Wards:	All
Reference Number:	

SUMMARY

This is a report on the long-term financial outlook for the City of Toronto.

The City of Toronto is the sixth largest government in Canada, with a total 2016 operating and capital budget of nearly \$15 billion. This represents an investment of over \$5,200 per resident, supporting services vital to our community and economy.

The budget is decided by City Council on an annual basis. This is a highly transparent process, providing detailed financial data and encouraging public participation.

This report explores the underlying conditions of City finances by reviewing the expense and revenue patterns of recent budgets. The past six years demonstrate a consistent pattern and are the focus of this analysis.

In order to provide the clearest understanding of the total cost and levels of municipal services, the analysis is primarily focused on overall (gross) expenses and revenues. Where appropriate, data are adjusted to ensure comparability over time. The general approach is to broaden discussion from the short-term narratives that typically dominate a single budget cycle.

The basic patterns of the recent past are straightforward. Overall City expenses have been constrained over the past six years, rising much more slowly than earlier periods. Costs have declined slightly when adjusted for the combined effects of inflation and population growth.

This expense constraint has been supported by savings from cost-shared social programs and deferrals of operating and, particularly, capital expense. The practice of deferring necessary expense is most evident in the increased number of unfunded capital projects and priorities, now estimated at up to \$29 billion over 15 years.

On the revenue side, reliance on property tax has decreased over the past six years. When adjusted for price inflation, property tax revenues have also actually decreased since 2010. Overall revenue growth has been supported by increases in utility rates for water and solid waste, Toronto Transit Commission (TTC) fares and other user fees and rapid growth in Municipal Land Transfer Tax (MLTT) revenues.

Each of these expense and revenue conditions has been critical in supporting the balanced budgets and selective increases in services achieved over the past six years. The analysis strongly suggests that the positive circumstances of the recent past are unlikely to continue and, at the very least, cannot form the basis for responsible future fiscal planning.

The report also provides a basic forecast of future expense pressures and revenue performance, adopting both a longer time frame and building in key inputs from City agencies. This analysis is necessarily high-level and will be subject to revision as Council provides specific direction and additional data emerges over time.

Quantitative projections confirm notable expense challenges in the future, in addition to typical labour and material cost pressures.

Projected expense pressures include:

- funding requirements for TTC and Toronto Community Housing Corporation (TCHC)
- annualized costs related to earlier capital and operating commitments
- addressing prior year deferrals of employee benefit liabilities and adjustment in response to the loss of the Toronto Pooling Compensation grant.

At the same time, it is anticipated that revenue growth will slow in the absence of policy changes.

Projected overall revenues for future years will be influenced by:

- continued low growth in property tax revenues
- leveling off of increases related to water and solid waste charges, TTC fares and other user fees
- anticipated maturity of MLTT revenues.

Looking towards future years, there are unlikely to be quick solutions or shortcuts to achieve balanced budgets as:

- annual surpluses are falling and are, at any rate, an essential element of the already inadequate capital finance strategy

- reserve funds are already at relatively low levels compared to other jurisdictions
- funding from the governments of Ontario and Canada will be essential to City building, but cannot replace long-term gaps in operating funding or fully offset unmet capital needs.

The overall gap between expense and revenue will likely draw attention. The intention is explicitly not to set off a sense of immediate urgency, expense slashing or revenue grab.

It is more important to focus on shifting the underlying structure of both expense and revenue management than to search for short-term measures. In a very real way, decisions over a number of years have made both further expense tightening and revenue increases inevitable. It is no longer appropriate or feasible to defer difficult financial decisions to future years.

The time has come for a direct conversation concerning the City's finances.

Remediation cannot be accomplished in a single step or outlined in a single report. It is not possible or appropriate to jump from diagnosis to solution in the absence of a meaningful engagement with Council and Toronto's residents and businesses. The problems have developed over years, and solutions will take both time and effort.

The report therefore outlines a series of principles and directions to guide the development of new strategies to manage expense and expand revenue.

Many of the principles and potential measures to be considered will be controversial. But real change will be required to ensure the City's financial stability into the future and to support Council's policy direction to invest in and support the growth of our community.

The 2017 Budget cycle will overlap with the long-term considerations described in this report. The pressures expected for 2017 may pose challenges. As the City undertakes the budget process over the coming months, it will important to ensure consistency between decisions taken in the short-term and the City's emerging long-term priorities.

RECOMMENDATIONS

The City Manager, Deputy City Manager & Chief Financial Officer and Deputy City Managers of Cluster A and B recommend that:

1. City Council request the City Manager and Deputy City Manager & Chief Financial Officer to report in the fall of 2016 on a framework for the City's multi-year financial and budget process.
2. City Council request the City Manager and Deputy City Manager & Chief Financial Officer to report in the fall of 2016 on strategies and processes to strengthen the City's strategic decision-making and financial oversight that will:
 - a. Support Council in setting priorities and outcomes in order to deliver its strategic agenda;

- b. Have a multi-year focus;
 - c. Integrate program planning for City services and the infrastructure delivered by City programs, through divisions and agencies, with the City's financial planning and budgeting to achieve the strategic allocation of resources to meet intended outcomes; and
 - d. Strengthen the City's financial management and oversight of City programs and agencies.
3. City Council request the City Manager and Deputy City Manager & Chief Financial Officer to report in the fall of 2016 on the framework for a multi-year Expenditure Management Plan, which should include short-term and long-term strategies to deliver a business transformation program that:
- a. Modernizes processes, improves productivity, embeds efficiencies to achieve excellence in service delivery and maximizes value for residents; and
 - b. Strategically manages assets to maximize their use in supporting service delivery.
4. City Council request the City Manager and Deputy City Manager & Chief Financial Officer to report in the fall of 2016 on multi-year revenue strategy that:
- a. Examines ways the City can optimize revenue generation from existing and new sources;
 - b. Identifies implementation costs, timing, and the sustainability of revenue options;
 - c. Establishes principles to guide the selection of potential revenues; and
 - d. Establishes a framework for the further application of both existing and new revenues
5. City Council request the City Manager and Deputy City Manager & Chief Financial Officer to undertake an asset optimization study, including consideration of how possible proceeds could be used to address the city's capital deficit through the City Building Fund and report in the fall of 2016.

Financial Impact

The recommendations and additional actions contained in the report are intended to improve the long-term financial stability of the City. It is expected that full implementation of the directions described through recommendations will ultimately require a shift in how the City approaches its annual budget and long-term service plans.

DECISION HISTORY

At its meeting of April 12-14, 2005, City Council unanimously approved the first Long-Term Fiscal Plan as recommended by the Ad Hoc Committee.

<http://www.toronto.ca/legdocs/2005/agendas/council/cc050412/cofa.pdf>

At the Budget Committee meeting on March 12, 2010, the Deputy City Manager & Chief Financial Officer provided an update on the 2005 Long-Term Fiscal Plan (LTFP).

<http://www.toronto.ca/legdocs/mmis/2010/bu/bgrd/backgroundfile-28412.pdf>

At the Budget Committee meeting on February 10, 2011, the Deputy City Manager & Chief Financial Officer gave a presentation on the 2012 Outlook and an update of the 2005 Long-Term Fiscal Plan.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2011.BU9.3>

At its meetings on October 8-11, 2013 City Council affirmed the City Manager's 26 Strategic Actions to guide the Toronto Public Service from 2013 to 2018 in the City's service planning, multi-year budgeting and performance planning process. Strategic Action #23 called for an update of the City's Long-Term Fiscal Plan.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2013.EX34.5>

At its meeting on May 5, 2015 City Council adopted recommendations related to the report "Recommended Multi Year Service Based Planning and Budgeting Process" including a request for the Deputy City Manager & Chief Financial Officer and the City Clerk to report back with recommendations concerning ongoing reviews of service plans, levels and performance.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2015.EX5.18>

At the Executive Committee meeting on December 1, 2015, the City Manager and the Deputy City Manager & Chief Financial Officer delivered a presentation titled "City of Toronto - Discussion of Fiscal Framework," which provided a multi-year perspective on City finances prior to the start of the 2016 budget launch.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2015.EX10.22>

At its meeting on February 17, 2016, City Council requested the City Manager and Deputy City Manager & Chief Financial Officer to commission an external consultant's updated analysis of the City of Toronto Act revenue potential and to include a Strengths, Weaknesses, Opportunities and Threats analysis of obtaining permission and collecting revenues through a diversified model.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2016.EX12.2>

ISSUE BACKGROUND

Update to the City's Long-Term Fiscal Plan

The City's first post-amalgamation Long-Term Fiscal Plan was approved in 2005. The City's practice has been to update the Long-Term Fiscal Plan every five years. An update was provided in 2010 and approved by Council in 2011. In keeping with the 5-year update cycle, staff are bringing forward this report on the City's financial direction to support development of an updated Long-Term *Financial Plan* (renamed from "fiscal" to reflect a broader strategic focus on both revenue and expense management) in 2016.

External observations regarding City finances

The annual budget process of City of Toronto has long included warnings with respect to financial sustainability. City Managers and the Deputy City Manager & Chief Financial Officers have expressed persistent concerns, suggesting a need for stronger expense discipline and additional revenue.

These concerns have been amplified by a number of external reports produced over the past decade.

In 2005, the report of the Governing Toronto Advisory Panel, *The City We Want – The Government We Need*, noted that “the downloading of an increased share of social programs, and the inheritance of a housing portfolio in need of serious repair, has placed additional, open-ended stress on an already severely stretched City budget.”

<http://www.toronto.ca/legdocs/2005/agendas/committees/pof/.../it004att.pdf>

In 2008, the final report of the City-commissioned Fiscal Review Panel, *Blueprint for Fiscal Stability and Economic Prosperity – a Call to Action*, concluded that “chronic revenue and expense problems and huge unfunded capital requirements and other contingent liabilities” exist. The report indicated that various approaches would be necessary to address annual shortfalls, including new revenue opportunities, cost containment and reductions; debt management strategies; and a more predictable fiscal arrangement with upper level governments.

<https://portal.publicpolicy.utoronto.ca/>

A 2014 review of Toronto's finances, *Is Toronto Fiscally Healthy?*, produced by the University of Toronto's Institute on Municipal Finance and Governance asserted that “Toronto faces cost pressures and its aging infrastructure and investment needs present a huge financial challenge.”

<http://munkschool.utoronto.ca/imfg/uploads/288/1581fiscallyhealthy5final.pdf>

In a 2014 report produced by CD Howe, *Baffling Budgets: Canada's Cities Need Better Financial Reporting*, the authors expressed concerns regarding limitations in the annual budget process for Canadian cities, including Toronto.

https://www.cdhowe.org/pdf/Commentary_397.pdf

Despite persistent concerns, through the annual budget process Council has been able to:

- plan for balanced budgets, as required by Ontario statute
- point to new services added each year
- emphasize low property taxes and low rate increases
- realize annual surpluses.

This report explores the factors that have helped to mitigate pressures which have been identified in the past and assesses the circumstances going forward.

Toronto's annual budget

Toronto's annual budget cycle is important. The budget process establishes the City's financial plan to achieve its priorities for the year. Budget allocations largely determine the quality and level of municipal services provided to the public. The City budget is used to establish funding for all City divisions as well as City agencies and corporations such as the Toronto Transit Commission (TTC), Toronto Police Service and Toronto Community Housing Corporation (TCHC).

As a starting point, it is useful to note some of the strengths and weaknesses of the annual budget process.

Among its strengths, the budget process provides detailed financial information and notes concerning the operating budget and 10-year capital plan. There are opportunities for public input and due diligence review of budget submissions for City divisions. These are subject to line-by-line review by Budget Committee.

There are, however, important constraints in the data and analysis available to Council and the broader public through the budget process.

The process focuses narrowly on the fiscal year under consideration. There is little detailed emphasis on prior year performance and outcomes. Forecasts for revenue and expense are generally limited to a two-year timespan. Most government budgets of comparable size and complexity contain additional analysis of multi-year expense, revenue, economic and intergovernmental factors.

The budget process emphasizes decision-making with respect to "net" or tax-supported budget items – usually translating this directly into potential changes to property tax levies. This supports accountability to the direct payers of property taxes, but often draws attention away from the very significant additional resources drawn from residents and business, particularly fees and utility charges. The "net" basis of accounting also records reserve draws as revenue, which potentially suggests that programs are more sustainably funded than is actually the case.

Finally, Council is provided with different levels of information for City divisions and City agencies. Divisions are subject to detailed review by Financial Planning staff and Budget Committee. Agency budgets, while also reviewed by City staff and Budget Committee, are subject to board direction and approval. Some of the City's most

significant expense drivers are embedded in the budgets of TTC, TCHC and the Toronto Police Service.

A more strategic approach to the City's financial outlook

The intent of this report is to take a step back and assess the overall approach to revenues and expenses of the recent past, and to do this from the perspective of residents and businesses that fund and benefit from the broad range of services delivered by the City.

This analysis involves consideration of financial information beyond any one budget cycle or term of Council.

This broader strategic approach involves:

- addressing gross or overall revenue and expense and their changes over time, in order to account for the full cost and all funding sources for public services
- Adjustments for inflation and population growth in order to reflect the underlying cost of services to Toronto residents and businesses, and ensure full comparability over time
- Providing a medium term projection of City expenses and revenues, covering the next 5 years.

The language and focus of this report is, at times, narrow and technical. It deals with the somewhat complex practices which define the reporting of operating and capital expenses and the City's various sources of revenue.

But the decisions that Council makes over expense and revenue measures reflect a broader and more consequential set of choices than may be apparent from the numbers alone.

Operating expenses are not simply government spending for its own sake – they are investments of vital public resources by Council towards a broader public good. Council has generally emphasized the expansion of, rather than constraints to, municipal services delivered to the public.

Similarly, capital investments address issues around livability, congestion and public space in our dynamic and increasingly dense and complex city. The capital investments that Council delivers in the budget are vital contributions to city building. They support the development of infrastructure that will ensure the health and vitality of Toronto for future generations.

City finances are often complex and seemingly abstract. But they are fundamental to achieving Council's collective vision for a growing, diverse and dynamic community.

Conditions and limitations of this analysis

Projections of future City revenues and expenses are inherently challenging and conditional. They are subject to future economic trends, changing service demands and

Council decisions. This report draws on conservative assumptions about future performance, using the best information currently available.

This analysis was expedited following the recent completion of the 2016 Budget process.

It is important that this information be provided for consideration by Council and the public at this stage. The intention is to provide a foundation for meaningful discussion and debate as Council gives consideration to the City budget for 2017 and beyond.

As staff undertake more detailed work on the City's Long-Term Financial Plan, there will be a need for broader consultation and input from the public. It is likely that at least some of the analysis will be corrected or refined as new information becomes available and Council decisions are made.

The City Manager, Deputy City Manager & Chief Financial Officer, the Deputy City Manager of Cluster A, Deputy City Manager of Cluster B, as well as the Executive Directors for Corporate Finance and Financial Planning are confident in the basic direction and the core analysis presented in this report.

COMMENTS

How the budget has been balanced – expense management

The analysis of Toronto's fiscal sustainability going forward starts with a focus on City expenditures.

This discussion addresses the whole of City expenses including those program areas supported through revenues collected from utility rates, user fees, government transfers and other sources. This provides the best indication of the total cost of government and understanding of overall service levels.

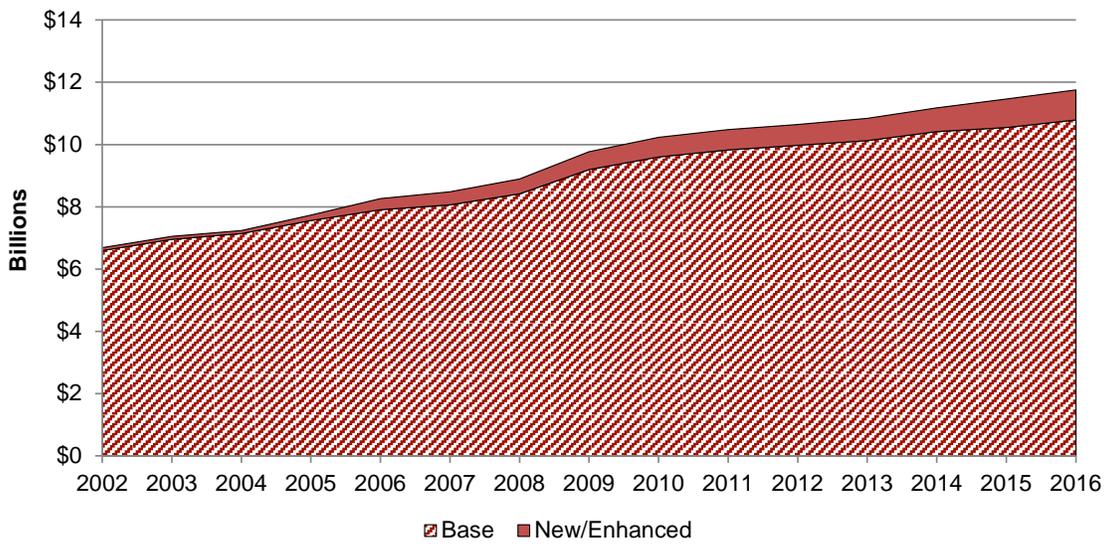
Overall expense growth

The total (or "gross") 2016 operating budget expenses for the City are \$11.75 billion, or about \$4,000 for every resident. Total capital investment for 2016 is \$3.2 billion, the current year allocation of the \$33.5 billion 10-year capital plan.

Figure 1 shows the growth in total operating expense over time. This is measured in nominal or current dollars – without adjustment for inflation. The 2005 to 2010 period saw substantial increases in expense, rising by approximately \$3.0 billion. From 2011 to the present the increase is considerably smaller, at roughly \$1.5 billion.

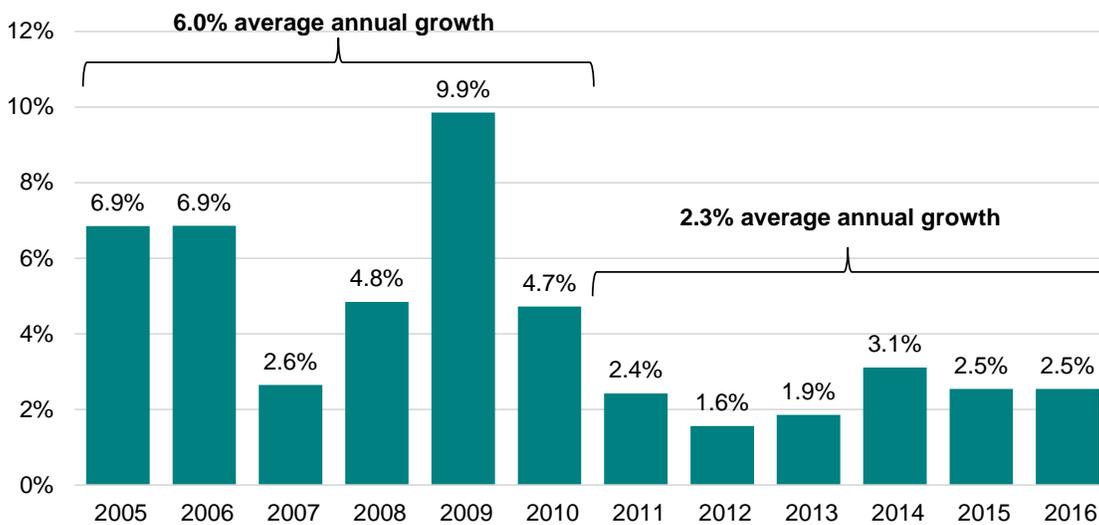
The majority of expense increase is driven by base inflationary and labour costs – increases necessary to maintain the same level of service year over year. Council has also annually approved new and enhanced service levels. Both components of growth are highlighted in the figure.

Figure 1 Nominal growth in the operating budget, base versus new and enhanced, 2002 to 2016



Over the past six years, budgeted gross expenditures have increased moderately at an average annual rate of 2.3 percent, as measured in nominal or current dollars. The cumulative increase has been 14.9 percent. Again, this varies considerably from the preceding six year period (2005 to 2010) when City expenditures grew at an average of 6.0 percent annually and 41.4 percent overall (Figure 2).

Figure 2 Nominal growth in budgeted gross expenditures, 2005 to 2016



Expense growth adjusted for inflation and population increases

Additional factors should be taken into account in order to better assess the overall trend and affordability of City expense. Inflation erodes purchasing power by approximately two percent annually, as measured by the Consumer Price Index.

After adjusting for inflation, the City's operating expense growth since 2011 falls to about 2.4 percent in total, or slightly less than one half percent annually.

As well, Toronto is a growing community with population increasing by 30,000 people or one percent each year. This both complicates service delivery as the City densifies and becomes more complex and provides a broader base of residents and businesses over which to spread the costs of government. (Further information concerning the CPI and population data used for this analysis are provided in the Supplementary Data attachment included with this report.)

Adjusting for both inflation and population allows for a more direct view on the cost of municipal services over time. Through this lens, overall City expenses and revenues have actually declined. Municipal services cost about \$165 or 3.8 percent less per resident compared to six years ago, measured in constant 2016 dollars (Figure 3). Government is less expensive on a per capita basis, despite the consistent addition of new services.

City expenses and revenues have also declined as a share of the Toronto economy. This is consistent with the operating constraint approaches adopted by the Province of Ontario and the Government of Canada in the recent past.

Figure 3 Inflation-adjusted per capita gross expenditures, 2010 to 2016 (2016 Dollars)



Sustainability of expense policies and trends

There have been significant changes in the composition of expense over the last six years. These shifts are crucial to explaining the capacity of successive Toronto budgets to both constrain overall expense growth and accommodate selected service enhancements. Some program areas show growth, while others have experienced savings (Figure 4).

The share of the City's annual expenses related to three broad service areas – transit, emergency services and rate-supported programs – has increased significantly. Since

2010, these program areas collectively account for almost three-quarters (\$1.154 billion) of the gross expenditure increase incurred by the City.

Expenditures for rate-supported programs have grown to compensate for historic underinvestment or to meet service expansion priorities. The majority of this increase is attributable to the budget of Toronto Water, which grew by 34.5 percent in real terms (26.3 percent when adjusted for population growth). Toronto Water has expanded expenses related to the state-of-good repair backlog, wet weather flow management and basement flooding protection.

Solid Waste Management Services has increased more modestly with 8.4 percent real growth and 1.8 percent growth on a real per capita basis, primarily to address waste diversion targets. As described in the revenue management section below, these costs have been entirely offset by equivalent growth in utility rates.

On an inflation-adjusted basis, TTC expenditures have increased by close to 14 percent since 2010. In inflation-adjusted per resident terms, growth in TTC is closer to 7 percent. These are moderate rates of growth and consistent with the increased density of the city and greater reliance on transit.

Emergency Services – Toronto Police Service, Fire Services and Paramedic Services – have been subject to substantial operating cost pressures, driven by increasing service demand and increasing labour costs. These cost drivers have been partially offset by efficiencies in service delivery. Taken together, these program areas have experienced inflation-adjusted growth of 5.8 percent and essentially flat inflation-adjusted per resident growth (-0.7 percent).

Figure 4 Budgeted overall expenses for 2010 to 2016 (millions)

Program Area	\$ Total in 2016	\$ Change from 2010 to 2016	% Change (Unadjusted)	% Change (Adjusted for inflation)	% Change (Real per capita)
Toronto Water	\$1,158	\$391	50.9%	34.5%	26.3%
Solid Waste Management	\$389	\$69	21.6%	8.4%	1.8%
Toronto Parking Authority	\$137	\$13	10.1%	(1.9%)	(7.8%)
Debt/CFC	\$722	\$107	17.4%	4.6%	(1.8%)
Emergency Services	\$1,772	\$279	18.7%	5.8%	(0.7%)
TTC	\$1,860	\$402	27.6%	13.7%	6.8%
Other Program Areas ¹	\$2,972	\$356	13.6%	1.2%	(4.9%)
Cost-Shared Programs	\$2,743	(\$94)	(3.3%)	(13.8%)	(19.1%)
Total	\$11,755	\$1,523	14.9%	2.4%	(3.8%)

¹Includes Transportation Services; Parks, Forestry & Recreation; Non-Program Expenses; Economic Development & Culture; Information & Technology; Social Development, Finance & Administration and others; see attachment for more details.

Savings in cost-shared program expenses

Increased City investments in growing program areas have been partially offset by lower expenses in cost-shared programs. These programs comprise a range of health and social

services which receive regular funding from the Province and/or the federal government. These offsets have contributed to achieving balanced budgets in recent years.

As a whole, cost-shared program expenses have decreased by \$94 million from 2010 levels, representing an inflation-adjusted decline of 13.8 percent. On a real per capita basis, these expenses are down by 19.1 percent overall (Figure 5).

The largest single change is in Toronto Employment and Social Services. This is a result of a stronger economy (resulting in reduced caseloads), a change in caseload mix with more singles than families.

In addition, Shelter Support and Housing Administration expenses have risen only slightly in nominal terms and are down significantly when adjusted for inflation and population. This is due in part to the fact that increases to operating funding to Purchase of Service providers have not kept up with the rate of inflation for recent years.

These program savings do not stem from a direct reduction in benefits for households or individuals provided by the City. The amounts paid through benefits such as Ontario Works and rent-gear-to-income housing subsidies as well as many other aspects of these cost-shared programs are fixed through provincial regulation.

However, lowered investment in these programs may contribute to waiting times for social housing, childcare fee subsidies and long-term care as well as the state of good repair backlog for social housing.

Figure 5 Cost-shared programs, budgeted overall expenses for 2010 to 2016 (millions)

Cost-Shared Program Areas	\$ Total in 2016	\$ Change from 2010 to 2016	% Change (Unadjusted)	% Change (Adjusted for CPI)	% Change (real per capita)
Children's Services	\$470	\$92	24.2%	10.7%	5.5%
Long Term Care Homes & Services	\$253	\$33	14.9%	2.4%	(2.4%)
Shelter, Support & Housing Administration (including transfers to TCHC)	\$677	\$17	2.5%	(8.6%)	(14.2%)
Toronto Employment & Social Services	\$1,099	(\$259)	(19.1%)	(27.9%)	(31.2%)
Toronto Public Health	\$243	\$24	10.8%	(1.3%)	(5.9%)
Total	\$2,743	(\$94)	(3.3%)	(13.8%)	(19.1%)

The City will not be able to rely on future savings from cost-shared programs.

The provincial assumption of full responsibility for the Ontario Disability Support Program and primary funding for Ontario Works means that any gains from lower caseloads will be realized by the Province.

In addition, savings in SSHA programs relate to expenditures funded entirely by federal transfers. Past spending pressures within TCHC were addressed by reserve draws and more debt financing; strategies which are unlikely to be sustainable at the same level going forward.

In their report from earlier this year, the Mayor's Task Force on TCHC states that the financial status quo for the TCHC is not sustainable. It can be expected that TCHC will be a source of significant pressure going forward.

Operating Savings

Each year through the budget process, the City has been able to report progress in addressing expense pressures through a focus on savings, generally in response to annual targets. (Annual targets set for the past six years are shown in Figure 6.) It is useful to explore the extent to which these represent direct and sustained reductions against earlier levels of expense and represent viable strategies going forward. All of the data in this section are in nominal or current terms.

Figure 6 Net budget savings targets, 2010 to 2016

2011	2012	2013	2014	2015	2016
-5%	-10%	0%	0%	0%	-1%

In some cases, savings reported by divisions and agencies have corresponded to significant reductions to City expense. The City has undertaken a range of cost containment and efficiency exercises in the past. The most extensive of these was the Service Review Program launched in 2011, which included a cross-corporate Core Services Review and more than 20 Service Efficiency Studies.

Due in part to service changes identified through the service studies, as well as ongoing line-by-line reviews of program area budgets, the City has realized almost \$300 million in efficiency-related savings since 2010. The City implemented significant cost-cutting measures resulting in the elimination of 1,374 positions and some service reductions in 2012. Some savings were controversial and at least partially reversed in subsequent budgets.

In most years, however, "savings" reported through the budget process do not necessarily represent reductions against the prior year's budget or actual expense levels.

In part this is a function of how the savings targets are set – against budget projections rather than actual spending. Savings targets are also typically set for net budget expenses, which means that divisions and agencies with alternative revenues may use these to offset targets. City divisions, which are subject to greater scrutiny by Budget Committee, typically show greater adherence to these targets than agencies.

Recent patterns of savings and efficiencies are nearing practical limits without service changes or other direction from Council.

City operating budgets have been highly constrained but, other than social assistance, have not shown actual and sustained reductions in the key cost drivers. This is largely a function of Council and agency decisions to prioritize maintaining or enhancing service levels, rather than service reductions.

Looking forward, further expense reductions would require strong action and a willingness to both reduce and sustain reductions in service levels. This would require significant changes in Council and agency direction.

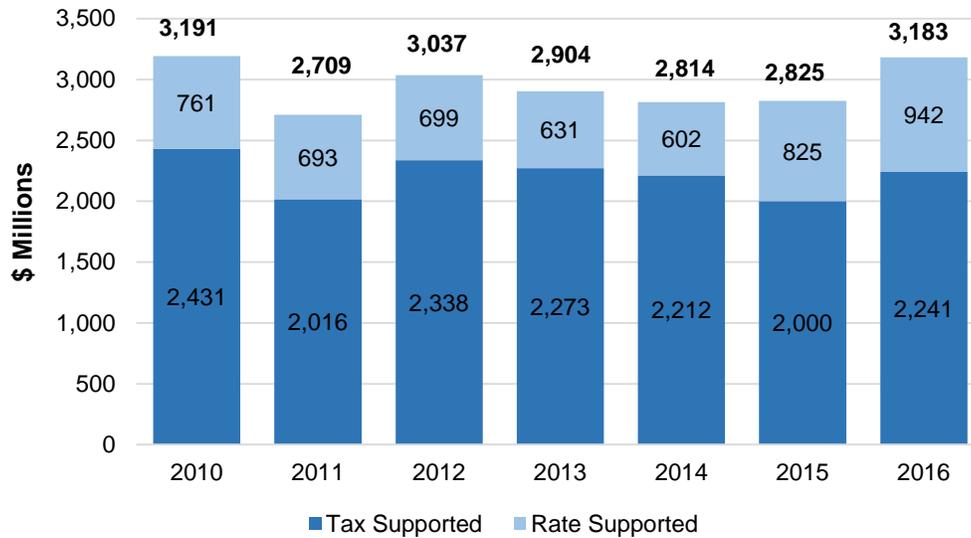
Short-term measures to address operating pressures

Most annual budgets have adopted some temporary measures in order to offset expense pressures, including temporary reserve draws and deferral of known operating pressures. The short-term measures used to balance the budgets in earlier years will place some incremental pressures on the 2017 Budget and beyond.

Deferred expenses related to major capital projects

Each year through the budget process, the City also allocates funding for capital investments. The data in this section are all in nominal or current dollars. Total annual capital planned investment has been in the range of \$3 billion over the past six years (Figure 7). This is essential to city building and represents the centrepiece of Council investment in long-term infrastructure.

Figure 7 Total annual capital budgets, 2010 to 2016



The level of capital spending is supported by:

- Borrowing, with debt service constrained to no more than 15 percent of property tax revenues
- Capital reserves, including as replenished by Council direction to assign 75 percent of any operating surplus to these
- \$218 million (2016) allocation in the operating budget to support capital financing (capital from current)

Available funds for capital projects are allocated on the basis of project need and readiness and confirmed by Council.

In addition to the funded capital plan, City divisions and agencies have identified needs or advanced planning for other major capital projects, which have not yet received funding.

These projects include Toronto's Transit Network Plan, the Gardiner Expressway and Lake Shore Boulevard East Reconfiguration, the George Street Revitalization project, TCHC repairs and TTC state of good repair backlogs and other emerging projects such as flood protection for the mouth of the Don River and waterfront public realm enhancements. Most of these projects have received in-principle support from City Council or the relevant board.

Taken together, they represent a major city building agenda and Council's future vision of Toronto.

The cumulative value of all unfunded capital projects, or the capital "overhang," is now estimated to be as high as \$29 billion over the next 15 years (Figure 8). This represents a \$6 billion increase from the 10-year projection of \$22.3 billion provided in the 2016 Budget process, after including forecasted expenditures for the transit network expansion approved in principle by Council in April 2016. This total will fall in line with future funding commitments from the Province and/or federal government.

Figure 8 Summary of unmet capital needs (millions)¹

Tier 1 Priorities (TCHC, TTC, Waterfront 2.0 and other City priorities)	
TCHC State of Good Repair Backlog (Province/Federal Share of \$2.6 billion requirement)	\$1,728
TCHC Capital Maintenance	\$650
TCHC Revitalization projects	\$356
Provincial Grant for Energy Retrofit (TCHC)	(\$29)
SOGR Backlog to 2% of Asset Value (All City, excluding TCHC/Toronto Police Service)	\$1,046
TTC Future Capital Needs (Board-approved)	\$2,679
George Street Revitalization project (SSHA)	\$480
Long-Term Care Homes & Services capital program	\$246
Other City Priorities	\$1,318
Lower Don Flood Protection	\$975
Waterfront Land Servicing (East Bayfront, West Don Lands and Keating Channel)	\$150
Waterfront Public Realm Initiatives	\$350
Waterfront Development Charges/Federal & Provincial Funding	(\$1,125)
Unfunded projects related to city-wide Environmental Assessments	\$2,000
Tier 2 Priorities	
TTC Future Capital Needs (not Board-approved)	\$2,323
Other Programs	\$597
Transit Expansion Initiatives (Council approved in April 2016)	
All Unfunded Transit Expansion Initiatives (preliminary & predesign estimates)	\$15,300
Total	\$29,043

¹These estimates include anticipated amounts to be contributed by other orders of government.

There is of course always a surplus of attractive projects relative to available public funds. Not all of this expense will be fully realized. However, projects which align with current Council priorities – including necessary transit investments – are likely to represent expense pressures in the next several years.

The current approved capital plan significantly underestimates necessary future expense, and provides an inaccurate picture of future sustainability. The City cannot continue to rely on deferring capital expense to achieve short-term financial objectives.

Summary of past expense policies and trends

The City has controlled expense growth over the past six years, as measured in current or adjusted terms. There has not been an overall expense problem.

However, that achievement has rested on a series of unique conditions, which are not likely to persist:

- reductions in funding requirements for social assistance and shared cost programs
- short-term savings and reserve measures
- deferral of expenses related to major city-building projects and programs.

How the budget has been balanced – revenue management

Budgeted revenue and expense match each year. In parallel with expense, it is important to consider the patterns of recent revenue performance. This again provides the basis for assessing future sustainability of current policies and trends later in this report.

City revenues have generally performed well over the past six years. In particular, the last three years have yielded average revenue growth of nearly \$300 million annually. The actual value of revenues collected has generally been above budget. Toronto has benefited from a number of factors beyond its control and difficult to forecast, including strong real estate market performance.

There are significant shifts in the share of overall revenue attributable to different sources, as shown in Figure 9. Key outcomes over the past six years include:

- decreasing reliance on property taxes
- long-term increases in utility rates, to create sustainable funding for water and solid waste services
- reliance on user fees, particularly those collected from transit users
- strong growth in the Municipal Land Transfer Tax
- moderate fiscal relief resulting from provincial uploads.

Figure 9 Budgeted overall revenues for 2010 to 2016

Revenue Source (Millions)	\$ Total in 2016	\$ Change from 2010 to 2016	% Change (Unadjusted)	% Change (Adjusted for inflation)
Property tax increase (Council-approved)	\$3,931	\$237	6.8%	(4.8%)
Property tax – cumulative assessment growth	N/A	\$232	6.7%	(4.9%)
Rate-based (Water, Solid Waste & Parking)	\$1,684	\$473	39.0%	23.9%
MLTT	\$527	\$351	199.8%	167.2%
TTC (Fares, ridership growth & other)	\$1,249	\$303	32.1%	17.7%
User Fees, Licenses, Permits	\$609	\$111	22.3%	9.0%
Provincial Uploads (savings)	\$251	\$148	7.3%	(4.4%)
Provincial Transfers ¹	\$1,710	(\$126)	(6.9%)	(17.0%)
Federal Transfers ²	\$155	(\$40)	(20.6%)	(29.3%)
Other revenue sources	\$1,639	(\$166)	(9.2%)	(19.1%)
Total Revenue	\$11,755	\$1,523	14.9%	2.4%

¹ Decline represents lower transfers from decreasing social assistance (Ontario Works) caseload and \$150 million in eliminated funding under the Toronto Pooling Compensation grant.

² Decline represents end of one-time federal funding towards housing affordability programs and declining transfers related to expiring social housing mortgages.

Property tax

Toronto and other Ontario municipal governments have access to a limited range of tax revenue sources. Direct taxation on the properties owned by residents and businesses represent by far the largest source of revenue for municipal services.

Property taxes have a number of important characteristics. These are highly stable and predictable. Corporate and personal income and sales taxes available to the federal and provincial governments demonstrate much higher volatility.

Property taxes are also efficiently assessed within a centralized provincial system. Tax collection is relatively straightforward and there is limited potential for evasion. Taxes on property are broadly borne and well matched to the overall financing of public goods. Provincial tax credits are intended to offset disproportional burden on households with lower incomes.

The stability and efficiency of property tax yield and collection are important to municipal governments faced with a legal requirement for annually balanced budgets.

Property taxes are also highly visible. Property taxes do not, under provincial legislation, rise automatically with property values. Municipalities are required to reset rates on an annual basis. Assessment growth does increase with new additions to the stock of real property, typically about one percent annually for Toronto.

Toronto has pursued two recent core objectives with respect to property taxation: (i) maintaining an overall tax rate increase at or below inflation. (ii) rebalancing property tax increases from historically over-burdened classes (industrial, commercial and multi-residential) to residential. The rebalancing of property tax burden is required by provincial legislation, although the City has made it a priority to progress slightly more quickly than mandated.

The cumulative result has been a sustained decline in the relative yield from property taxes:

- a gain of \$237 million or 6.8 percent from 2010 to present, on a base of nearly \$4 billion, through Council-set rate increases
- adjusted for inflation, the City is budgeted to collect 4.8 percent less through Council-approved property tax increases in 2016 than it did six years ago
- a decrease from 60 percent in 2006 to 49 percent in 2016 as a share of the City's total budgeted own source revenue.

Toronto residential property taxes remain well below the level of other large Ontario municipalities, measured on an average household basis. Council's priority towards limiting residential property tax increases to the rate of inflation has translated into overall property tax growth that is actually less than the rate of inflation.

Utility rates

Over the past six years, a greater share of revenue increase has been attributable to water rates, Solid Waste Management rates and Toronto Parking Authority revenues than to any other single source of revenue.

The strong growth of utility rate-based revenues is primarily due to Council decisions to create a system in which increases in utility charges are matched to capital and operating needs. Toronto Water's funding strategy involved consistent nine percent annual water rate increases from 2006 to 2014 and eight percent increases in 2015 and 2016. This strategy of dedicated revenue sources investments has allowed Toronto Water to address the major expense priorities described earlier.

Solid Waste Management Services has also established a sustainable source of funding for ongoing operations and capital investment since it transitioned from a tax-supported program to a fee-based program in November 2008.

User fees

In general, revenues attributable to user fees (such as those collected from recreational program users and paid-entry venues like museums), licensing fees and permitting fees have been relatively stable. Since 2010, these fees have grown just slightly more than inflation, by an average of less than one percent annually in adjusted terms.

TTC revenues

TTC revenues have grown considerably over the past six years, due to increases in fare box revenues (from TTC fare increases and ridership growth) as well as other sources like advertising sales. TTC fares are set annually by the TTC Board to fund operating expenditures, above the amounts provided through City funding, with due regard given to the impact on customers and ridership.

Over the past six years, TTC revenues have increased by an average of almost \$50 million annually – representing cumulative inflation-adjusted growth of 17.7 percent over 2010 levels or about three percent per year.

During this time, more incremental revenue has been collected by the TTC (\$303 million) than from Council-set increases to the property tax rate (\$237 million).

Municipal Land Transfer Tax

Toronto is the only municipality in Ontario with the authority to levy a tax on land sales – referred to as the Municipal Land Transfer Tax or MLTT. Administratively, the MLTT is assessed and collected with the Province's Land Transfer Tax and remitted to the City. MLTT is borne by the relatively small number of residents and business which engage in real estate transactions over the course of any given year. Real estate market performance is traditionally somewhat cyclical. MLTT revenues are much less certain than most other major municipal funding sources.

With the exception of the recessionary declines in 2008 to 2009, MLTT performance closely aligns with a period of rapid growth in real estate transaction volume and prices. Over the past six years, \$351 million or almost a quarter of the City's net increase in revenues is attributable to this source.

In inflation-adjusted terms, the MLTT has grown by 167 percent from 2010 levels. This is about seven times greater than the growth rate for any other source of City revenue during this time. As a result of this rapid expansion, the City now collects about 1.5 times more revenue through the MLTT than it did six years ago.

The rise in the MLTT has been essential to Council's ability to maintain at or below inflation-level property tax increases. To a large extent, current finances rely on what has been a windfall revenue gain from a buoyant real estate market.

Provincial impact

The sequence of amalgamation and provincial downloading of services to municipalities in the late 1990s and early 2000s provided significant financial challenges for Toronto. The City was given increased financial responsibility for social housing, social assistance, other provincially-mandated services and transit. The operating and capital pressures associated with these programs, many of which preceded the download, continue to impact the City's budget today.

Starting with the passage of the *City of Toronto Act* (COTA) in 2006, the Province has provided unique flexibility to Toronto with respect to fiscal policy, including the ability to implement new revenue tools, such as the MLTT.

The upload of key cost-shared social programs has provided some financial benefit. This will represent a gross reduction of \$309 million in City expenses, when fully phased-in by 2019.

The loss of Toronto Pooling Compensation, announced in 2013 and implemented by the Province over the 2014 to 2016 years, has partially offset these gains. When accounting for the provincial elimination of Toronto Pooling Compensation grant, the net impact to the City's gross budget is a savings of \$180 million.

The 2015 budget largely deferred the adjustment to the loss of Toronto Pooling Compensation through the use of a self-financed loan from capital. The 2015 Budget identified \$25 million of expense savings to bridge this gap, and the balance of any further revenue or savings measures remains as an outstanding pressure.

Preliminary expense projections for 2017 to 2021

The earlier discussion of expense illustrated the extent to which the conditions which supported low expense growth – particularly savings in cost-shared programs and the practice of deferral financing decisions with respect to capital projects – do not provide a viable basis for future planning.

It is important to provide an empirical or forecast basis for future Council decision making. As emphasized earlier, projections are inherently uncertain and will be adjusted as better information becomes available.

Figure 10 represents an early estimate of operating expense pressure over the next five years. This shows cost pressures identified by agencies and divisions to maintain current levels of service. Utility expenses are fully offset by revenue and do not contribute to a fiscal gap. These are shown because, consistent with the analysis in this report, they represent a share of gross cost pressures and service improvement for residents and businesses.

It is important to note that the data are presented on an incremental basis – each year adds on the prior pressure.

Some factors help to lower actual costs in the future, notably savings efforts. Other factors may drive expense pressures higher than the projections provided here, including:

- pressures from Toronto Police Service. (In this analysis, pressures are assumed at \$0 and will be addressed by management actions and result in no direct or indirect pressure on other City expenses)
- any new investments or priorities are identified by Council, including the Poverty Reduction Strategy

- implementation of measures resulting from the recommendations of the Mayor's Task Force on TCHC
- any of the deferred capital projects that are actually undertaken, including transit investment

The full cost of incremental financing of the \$29 billion capital overhang is separately described in Figure 11 for reference. This will be offset to some extent by contributions from other orders of government.

These pressures are similar to those shown in past budget cycles. The overall rate of growth implied is approximately five percent for 2017, a figure well within Toronto experience. The difference is that the factors which offset those earlier expense projections are less likely to materialize and will not offer relief in the future. Future expense budgets will require more realistic analysis of sustainability.

Figure 10 Projected incremental base expense growth, 2017 to 2021

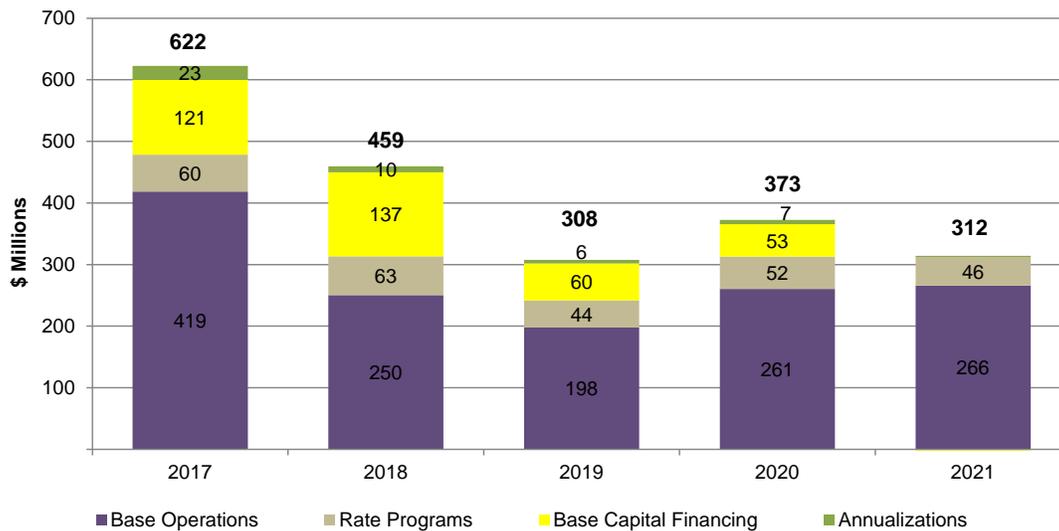
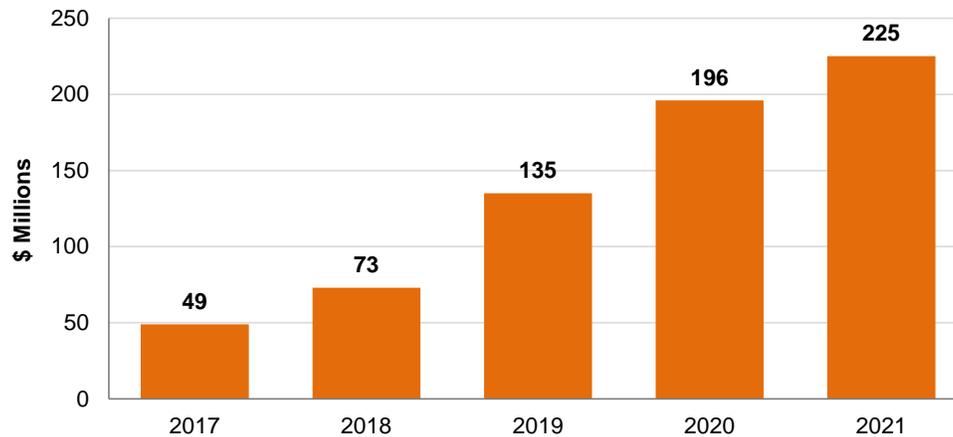


Figure 11 Projected incremental debt charge growth for unmet capital needs, 2017 to 2021



Preliminary revenue projections for 2017 to 2021

As with expenses, it is important to assess the sustainability of revenue trends into the future.

The estimates provided in Figure 12 are based on recent Council policy direction:

- extending existing water and solid waste utility fee policies, which are matched to expense and thus fiscally neutral
- holding the residential property tax to the rate of consumer price inflation which is assumed at two percent
- maintaining current policies on commercial and multi-residential protected property tax classes;
- growing TTC and other user fees at the rate of consumer price inflation;
- provincial uploads reaching maturity in 2019, consistent with negotiated agreements

This forecast also models the potential revenue from a special dedicated property tax levy for priority transit and housing capital projects (also known as the "City Building Fund") which was approved through the 2016 Budget process for inclusion in the 2017 to 2021 preliminary tax-supported budgets.

As per Council direction, this assumes a 0.5 percent residential property tax increase to be considered in 2017 that increases by an additional 0.5 percent in each year from 2018 to 2021.

The MLTT is assumed to be sustainable at current levels, and includes an additional \$20 million realized through the first three months of 2016.

The performance of real estate markets is difficult to predict. The MLTT could continue to grow strongly over the coming years; but there is also the possibility of contraction. MLTT remains a somewhat uncertain source of revenue for Toronto in the years ahead.

As displayed in Figure 12, a revenue forecast built from these assumptions will continue to exhibit positive growth over the coming years. With the exception of 2017, revenue is expected to grow incrementally by approximately \$210 to \$260 million annually through 2021. The below the line (i.e., negative) figure showing for 2017 is a function of reversing one-time measures adopted to support the 2016 Budget.

These projected revenue levels are considerably lower than those experienced for the past three years, showing a base case in the absence of double digit MLTT increases or Council decisions (Figure 13).

Additional detail concerning both the expense and revenue pressures anticipated for 2017 are described later in this report.

Figure 12 Projected incremental revenue growth, 2017 to 2021

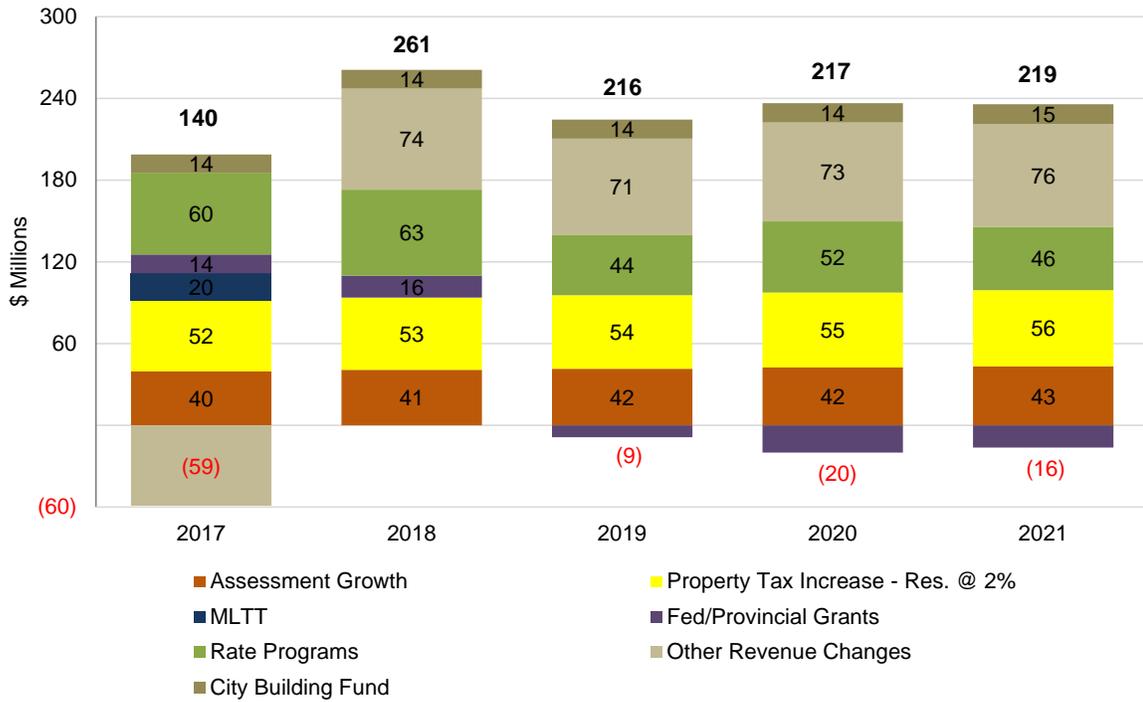
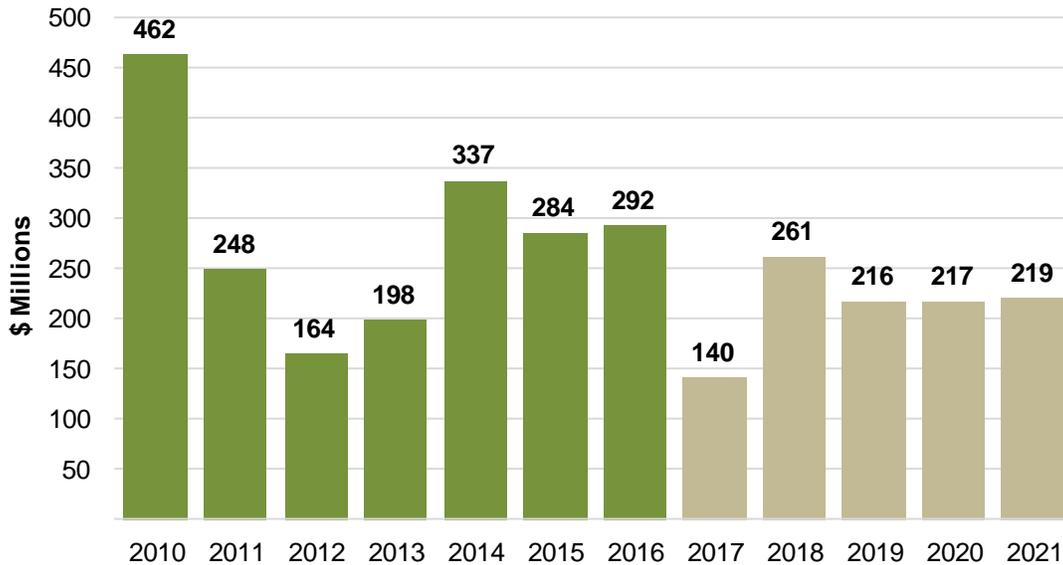


Figure 13 Incremental revenue growth, 2010 to 2016 (budgeted) and 2017 to 2021 (projected)



Projected net pressures for 2017 to 2021

The figures below shows the net budget pressures or "gaps" which would result from the expense and revenue forecasts contained in this report. They provide the best and most conservative assumptions regarding the combination of annual revenue and expense measures required to sustain the current service volumes over time.

For 2017 this represents a significant unresolved pressure of 14 percent on a net basis – essentially a gap to be managed through a combination of expense reduction or revenue increase or both.

Figure 14 presents incremental values. As such, it provides annual estimates of the financial pressure, based on the assumption that the pressures from the previous year(s) are fully addressed through sustainable expense or revenue measures. If they are not addressed, or are simply deferred through short-term measures, these pressures will accumulate over years. Figure 15 displays the cumulative impact if no action is taken to address these pressures in a sustainable way. (It is reasonable to assume that the pressures for out years will fall somewhere between these values expressed in these two figures.)

Figure 14 Projected incremental net pressures, 2017 to 2021 (\$ millions)

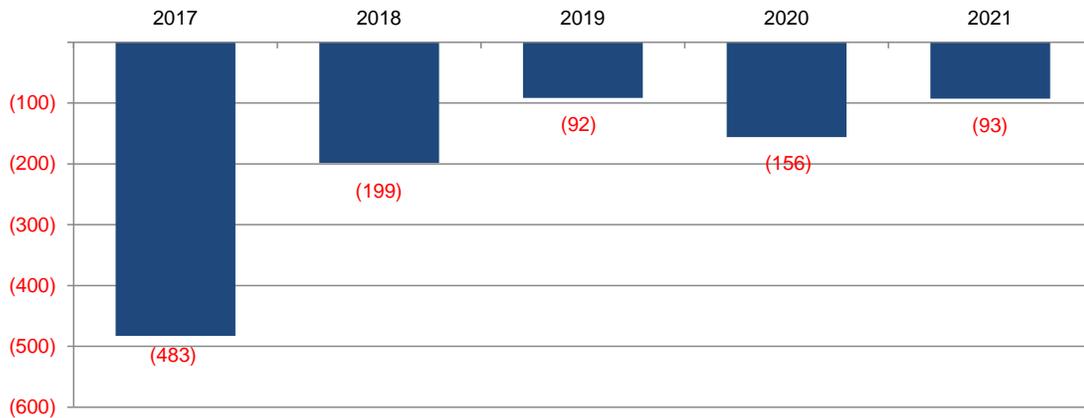
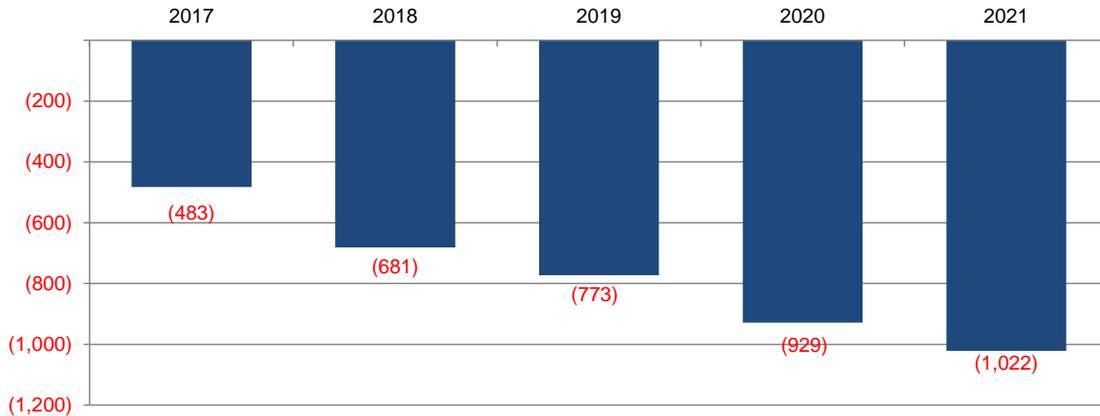


Figure 15 Projected cumulative net pressures, 2017 to 2021 (\$ millions)



Summary of projected net pressures for 2017

This report is primarily concerned with medium-term projections and providing Council with a sense of potential future policy directions. However, there will also likely be considerable interest in the 2017 budget cycle.

Figure 16 on the following page provides an early indication of the potential challenges anticipated for 2017.

This information is presented on a "net basis." This is distinct from the earlier analysis in this report, but consistent with the normal presentation of pressures as part of a budget launch.

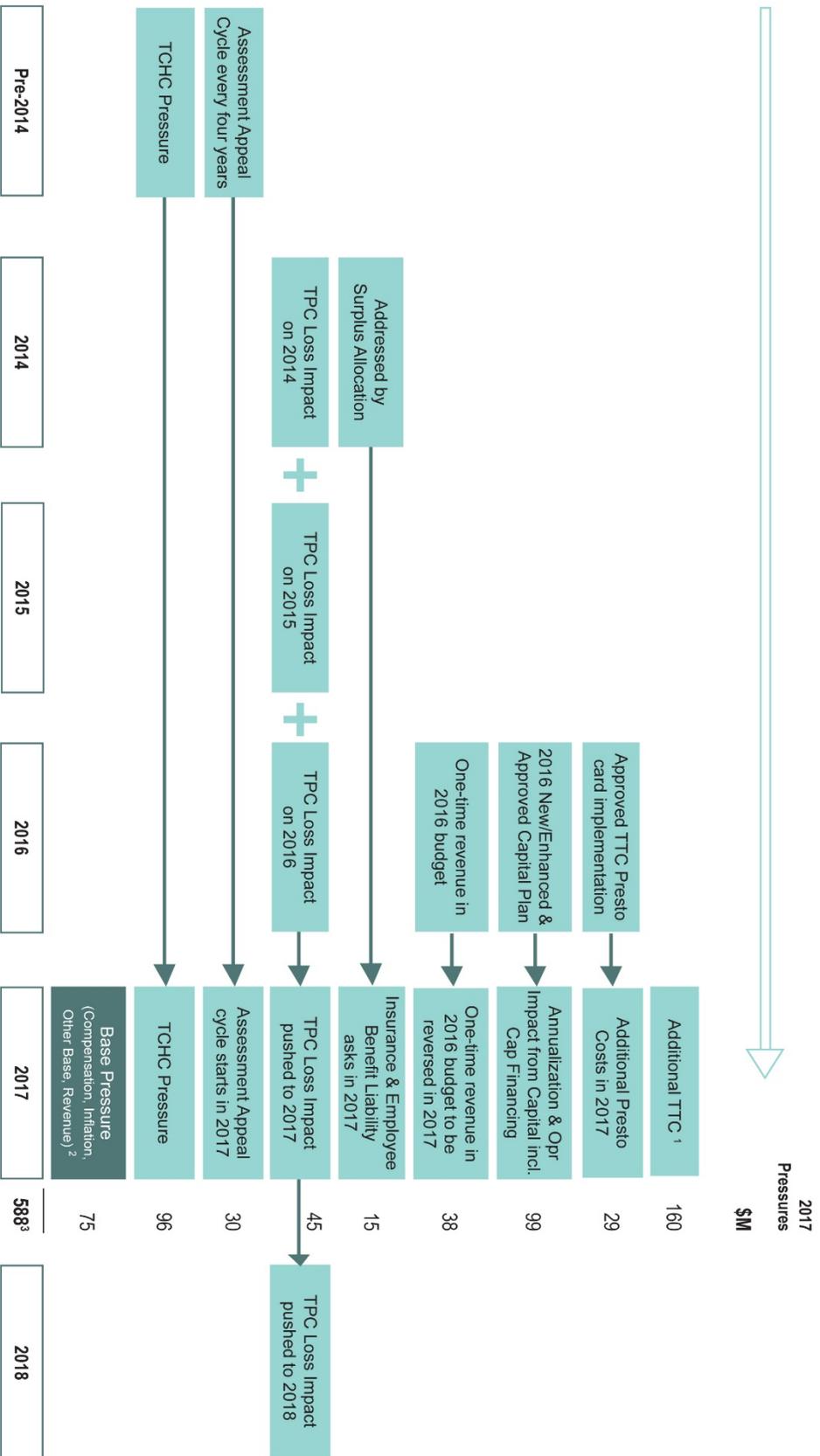
This means that the figures shows the anticipated opening pressure on the property tax base (\$588 million) after all offsetting expense and revenue are factored in. Subtracting forecasted revenues from property tax, assessment growth and City Building Fund revenue for 2017 reconciles to the \$483 million gap noted in the preceding section.

The key sources of pressure are:

- long-term inflation and core cost drivers;
- TTC pressures and annualization; including contractual payments for Presto use;
- TCHC operating gap, as reserve and debt financing offsets are less tenable;
- Realization of deferred pressures for Toronto Pooling Compensation loss and employee liabilities;
- Catch up with and one-time expense and revenue measures implemented in prior years, which must now be reversed.

As with the earlier analysis, this is a base case which does not account for any additional new expenses or savings that may be approved by Council. Any incremental operating investments or new capital projects will increase expense. Any savings initiatives will offset expense.

Figure 16 Summary of 2017 net pressures based on current assumptions



Note:
 1. Additional TTC pressure includes revenue shortfall and base salary increase, but excludes Presto and service improvement cost increases.
 2. Base pressure mainly includes base salary increases (excl. TTC and Police), base non-salary inflation increases, as well as other base expense and revenue changes (incl. user fee, MLTT, upload), etc.
 3. Total 2017 operating pressure of \$588m excludes service improvements, debt costs for unmet needs, and Police. Net pressure is \$483m after Tax Rate Increase (\$52m), Assessment Growth (40m), and the City Building Fund estimates (\$13.5m).

Potential shortcuts to balance the budget

Before undertaking next steps towards a more sustainable financial model, it is important to consider the extent to which Council may rely on several potential approaches. To varying degrees, these have been used in past years to achieve balanced budgets. These approaches carry a degree of risk and/or are inadequate to address projected pressures.

Provincial or federal government funding

The funding models for Council-approved capital projects have traditionally relied on assumptions for future funding contributions from the governments of Ontario and Canada. Council has a broad range of requests, primarily centred on transit, waterfront projects and social housing. These are projects of provincial and national concern.

It is hoped that Canada and Ontario will provide new investments towards these priorities. But these funding contributions are likely to be contingent on matching or incremental City commitments. Furthermore, the fiscal challenges that Toronto will need to address are long-term and structural while investments from other orders of government are anticipated to be short-term and project specific.

Municipal Land Transfer Tax

It is possible that MLTT will continue to perform strongly into the future. But the City's degree of reliance on this single revenue source is already at a point of potentially high risk for a municipal government.

Draw down reserves

Past budgets have relied substantially on one-time reserve draws to address operating pressures. On a comparative basis, the City's aggregate reserves and reserve fund account balance is much lower than those in other Ontario jurisdictions. Continued use of reserve funding will increase the City's exposure to financial risk.

TCHC does maintain reserves that, while diminished, may be applied to offset expense pressures. This would worsen what are already acute future capital financing shortages for TCHC. (TCHC could also continue its aggressive borrowing program; however, debt levels are reaching their capacity for repayment and require City guarantees.)

Manage down the surplus

The historic experience of high surpluses seems to similarly have reached a conclusion. The 2015 surplus is likely to be well under \$150 million – less than 1.5 percent of overall expense. This represents only a modest buffer against unanticipated pressures. By Council policy, surpluses are largely directed toward future capital investment.

Any planned reduction in the surplus requires cuts in future capital projects.

Lower "capital from current" financing

It is possible to reduce the operating funding used to support capital projects. But this would require a direct reduction in capital projects.

Conclusions and consequences of this analysis

It is important to consider the potential consequences of inaction. Any operating deficit or the threat of an operating deficit will require immediate and potentially dramatic action to remedy. Options are limited in the short-term and default to solutions such as blanket spending freezes and immediate fee and tax increases. Unplanned actions almost always generate unintended consequences, future pressures and are largely ineffective in addressing structural challenges.

A second and potentially greater consequence relates to Council's vision for City services and investments going forward, and the financial plan it will pursue to achieve it.

If Council decides to affirm a more restrained vision going forward, this would mean that over the coming budget cycles Council and staff will focus primarily on expense management measures and ensuring the efficient delivery of a smaller footprint of municipal services.

As noted above, Council has not pursued this direction through previous budget cycles. In fact, Council decisions have tended towards additional investment and, in some cases, reinstating previously cut services and expenses.

Council may continue to pursue a strong city building agenda that includes investments to maintain or strengthen municipal services. These priorities may include transit enhancements, the Poverty Reduction Strategy, addressing the Mayor's Task Force recommendations to stabilize TCHC and continued support for economic competitiveness.

Council may also endorse new capital projects, particularly those required to comply with provincial mandates (e.g. requirements under *Accessibility for Ontarians with Disabilities Act*), address state of good repair needs and achieve its transit priorities.

It is no longer appropriate to "kick the can down the road" on these difficult financial decisions. There is a need for a more strategic approach to financial planning. The remainder of this report provides some preliminary directions and principles for how this may be achieved in the months and years to come.

Next steps for Toronto's long-term financial plan

The primary objective of this report has been to describe the patterns and challenges underlying the Toronto fiscal context, and the extent to which the outcomes of the recent past provide an unreliable basis for future decision-making.

This analysis is essential; and it will almost certainly require further conversation at Council and within the community to clarify the assumptions and conclusions presented in this report.

But the diagnosis of the problem is only the first step.

The balance of this report outlines key considerations and proposed actions, subject to Council direction, for the development of a sustainable long-term financial plan. The development of this plan will involve measures to be implemented from the perspective of both long-term expense and revenue management. Specific options and recommendations are likely to come forward through a series of subsequent reports and through the annual budget process, as appropriate.

This will be an iterative and likely challenging process, involving complex fiscal parameters and estimates, dialogue with Council and committees and input from the community.

The following actions will be required:

- Manage immediate pressures and avoid compounding financial challenges (e.g., avoid further expense deferral tactics that simply push off rather than address core cost drivers.)
- Undertake a pragmatic prioritization of future operating investments and capital expense, on a multi-year basis.
- Implement longer term expense constraint.
- Explore material revenue gains, through both existing and potentially new tax and non-tax sources.

This process will require some time, although in some cases work will necessarily be expedited over the next few months to address the pressures identified for the 2017 budget cycle.

Long-term expense management

As the analysis in this report makes clear, the challenges in City finances are not primarily a function of rising costs. The City must, however, maintain a fundamental focus on responsible and effective expense management. It is imperative that divisions and agencies, working with Council direction, explore efficiencies and cost reduction in order to create resources for other investment priorities. This work must be done before imposing any additional financial burden on Toronto residents and businesses.

As Council gives consideration to a long-term approach to financial planning, it should be focused on the considerations described below.

“Whole of government” approach to expense management

It is important to take a comprehensive approach to expense management which accounts for all aspects of City operations.

Based on the foregoing analysis, it is reasonable to expect that the primary drivers of expense over the next five years will be emergency services, transit operations and the financial challenges of TCHC. The decisions that Council takes with respect to these emerging expense needs will largely determine the overall expense level of the City going forward and the consequent revenue requirements.

The City has set out annual savings targets in recent budget processes with varying degrees of compliance and impact. It is important that Council approve these targets and City divisions and agencies provide options to meet these targets. Measures that simply defer expenses to future cycles should not be accepted.

Consideration also needs to be given to how these targets are set. In general, the successful expense containment efforts of large governments have involved:

- differential targets based on priority of expense, including particular focus on key cost drivers
- multi-year targets to allow for innovation and investment which create the potential for longer-term savings
- centralized investment pools for the purposes of funding essential restructuring costs

Link program and financial planning

Some of the most fundamental and important steps in achieving successful long-term financial management relate to Council decision-making and direction. The lack of sufficient integration between program planning and the budget process has allowed for the development of unfunded operational plans and, particularly, the significant capital overhang.

Council has an opportunity to establish broad guidance for divisions and agencies with respect to the likely level of incremental investment available for services and City-building infrastructure, before plans are developed and come forward for approval.

Review and develop a funding plan for priority capital projects

It may be appropriate for Executive Committee to review the overall capital budget with a view to determining what is necessary for City building investment. The designation of capital programs as funded versus unfunded is currently done on a somewhat arbitrary basis. It is constrained by the City's debt limit and associated affordability concerns. Decisions regarding which projects are allocated for funding should be made by Council.

In addition, substantial City resources are devoted to capital projects. The vast majority of these are delivered on time, on or under budget and represent appropriate value for money. There may be potential to further improve capital project management by:

- consolidating and strengthening major project management
- developing improved costing models, including consideration of maintenance and operating costs
- better mapping cash flow and matching budget needs to operational capacity.

Council may also wish to explore the potential to raise the debt service ceiling of 15 percent of tax revenue, allowing for increased investment in the shorter and medium terms. This policy limit is within the purview of Council to modify. But it must also be recognized that any increases in the debt service ceiling will ultimately require new revenues to fund the additional debt charges.

Maximize savings through efficiencies and responsible service level changes

In order to achieve substantial savings going forward, consideration will have to be given to the existing service levels delivered by City divisions and agencies. In some instances, policy outcomes may be maintained or enhanced through innovative approaches to service delivery. But there are limits to savings that can be achieved without reducing service levels.

Savings opportunities and proposals by divisions and agencies should be assessed against common criteria including:

- level of savings
- timing and duration of savings
- transactions costs
- execution complexities and risks
- prerequisites, including early stage investments
- risk of adverse or unintended consequences
- compatibility with other City objectives, including living wage and equity goals

Focus on long-term labour cost drivers

The largest single driver of City expense relates to the wage and benefits compensation of City and agency workers. Expense tends to climb moderately over time, and the pattern of settlements for City workers now falls below expected inflation.

Recent emergency service and TTC labour contracts have resulted in considerable wage pressures. These are negotiated in the context of mandatory arbitration models, which tend to limit the potential for substantial cost savings.

Numerous City agencies negotiate separate agreements with a number of bargaining agents. This raises challenges in terms of consistency, fairness and overall efficiency. It

may be appropriate to explore more coordinated approaches to achieving fair and equitable agreements with leading bargaining agents.

Contracting out and alternative service delivery

The City has a number of services which are delivered through external contractors, both for profit and not-for-profit.

Contract and alternative service delivery may provide the potential for service efficiencies and further savings. These must, of course, be consistent with City and agency obligations under collective agreements and applicable legislation, including successor rights. The assessment of any potential external contractual arrangement must balance:

- potential savings
- potential impacts on current and future labour force
- City policy intentions regarding precarious work and living wages
- robustness of the competitive market and potential exposure at the completion of an initial or subsequent contract
- ability to effectively monitor and ensure appropriate quality and outcomes.

Back office savings

The City has sought to achieve savings in shared services over a number of budget cycles. There are further opportunities for modernization of back office functions, including:

- completion of planned shifts to automated attendance management, direct deposit of expense and other payments
- consolidation of shared services with major agencies
- shift of some municipal functions and services to e-channels
- integrated and shared communications and public outreach, including with agencies.

The City's pending Real Estate Review may offer options for potential consolidation and policy harmonization.

Limits to savings

It is important to have realistic expectations of savings initiatives. Toronto budgets have, as noted, been characterized by a wide range of stringent targets and considerable fanfare. Despite these, year over year expense has increased. The structural drivers of many expense pressures have not yet been addressed and cannot be realistically held without significant policy change. Council has frequently reversed earlier savings measures.

Senior governments often set stringent savings objectives over time. As a practical matter, these are rarely met. This is not to detract from the critical importance of savings and efficiency, but rather to ensure that objectives are both appropriate and will be achieved.

Long-term revenue management

Council should adopt an overarching and strategic revenue framework based on sound revenue management strategies. There is a need to take a more deliberate and strategic approach to revenue policy.

The challenges associated with revenue should not be addressed in a single step. As with expense, these are structural in nature. Major policy shifts would be required to mitigate risk, encourage equity and provide for fairer and more transparent basis for Toronto public finance.

Broad policy considerations

It is important that all revenues be treated with equal respect and seriousness – taxes, utility charges and fees represent resources drawn from Toronto residents and businesses.

Budget transparency is critical in terms of user and utility fees.

It is essential that Toronto's principal revenue sources are resilient and support predictable achievement of a balanced budget. Any deviation must be corrected in the following fiscal year, potentially requiring unplanned and difficult expense and revenue measures.

Similarly, as Council recognizes increased permanent expense – essentially all increases in operating expense – it will be critical to ensure matching increases in highly stable revenue sources.

Short-term or uncertain revenue sources should not be devoted to base expense.

Property tax remains the default and most stable revenue source available to the City, barring changes in provincial policy.

User Fee Policy

Toronto has a number of policies which match fees to benefits accruing from public services. It may be appropriate to expand the fee-for-service model, subject to:

- avoiding indirect taxation
- overall access, social cohesion and economic development goals.

Preferential price or price concession policies may offer some potential tightening to limit leakage.

Asset reviews

The City holds a wide variety of land, corporate and other assets. Optimizing asset performance and disposition of under-utilized assets may improve the City's fiscal position.

City assets should be reviewed in terms of potential to increase returns within given ownership, governance and operational structure(s) and the value of partial/full sale in order to fund key city-building initiatives.

Any proposal should be assessed in terms of:

- value
- impact on future revenue stream
- tax and other leakage
- broader policy objectives.

The following summarizes recent activities in regard to key strategic assets:

- *Toronto Hydro Corporation*: A recent expenditure and revenue plan from the Ontario Energy Board anticipates positive income growth through capital reinvestment, leading to higher dividends paid to the City over time, accompanied by a period of higher debt levels.
- *Toronto Parking Authority*: A report in 2016 is expected to comment on the parking rate strategy and make appropriate changes to revenue sharing.
- *Land holdings*: A Real Estate Review is currently being conducted by the City's Chief Corporate Officer to make recommendations to improve the City's approach to the use and disposition of surplus lands by various City divisions and agencies.

City Building Fund

Council has directed the incorporation of a City Building Fund into the 2017 Budget process. This will establish a vital mechanism for providing a segregated funding mechanism. This can offer public and potentially intergovernmental reassurance that selected new revenue sources are applied to new investments.

The City Building Fund offers an important mechanism to:

- hold revenues from an incremental property tax levy, as proposed by Mayor
- receive incremental federal and Ontario support
- hold potential gains from incremental asset performance or monetization
- hold potential proceeds from new revenue measures

Revenue options report

Council has requested that staff report back on potential revenue measures to the June 2016 meeting of Executive Committee. The staff report and any subsequent analysis will address the following with respect to revenue tools:

- Federal/provincial approvals (e.g., whether options are currently permitted under COTA or intergovernmental cooperation or change in federal/provincial legislation is required.)
- yield or revenue potential
- incidence and burden
- fairness (e.g., progressivity or regressiveness with respect to income and wealth and intergenerational equity should also be considered)
- economic efficiency
- avoidance potential
- adverse impacts on behaviour and/or existing revenues
- timing requirements to implement
- costs and complexity of implementation and ongoing administration.

Among the alternative revenue tools under consideration and study are:

- alcoholic beverage, tobacco and entertainment/amusement taxes
- motor vehicle ownership registration tax
- parking tax
- road pricing (excluding tolling the Gardiner and Don Valley Parkway which are subject to a separate study)
- development levy
- hotel tax
- municipal sales tax
- municipal share of income tax

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Giuliana Carbone
Deputy City Manager (Cluster A)

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ATTACHMENT

Supplementary Data

Supplementary Data

Summary of expense growth, 2010 to 2016

Program (Millions)	\$ Total in 2016	\$ Change from 2010 to 2016	% Change (Unadjusted)	% Increase (Adj'd for Inflation)	% Change (Real Per Capita)
Toronto Water	\$1,158	\$391	50.9%	34.5%	26.3%
Solid Waste Management	\$389	\$69	21.6%	8.4%	1.8%
Toronto Parking Authority	\$137	\$13	10.1%	(1.9%)	(7.8%)
Debt/CFC	\$722	\$107	17.4%	4.6%	(1.8%)
Emergency Services	\$1,772	\$279	18.7%	5.8%	(0.7%)
<i>Toronto Police Service</i>	<i>\$1,134</i>	<i>\$178</i>	<i>18.6%</i>	<i>5.7%</i>	<i>(0.7%)</i>
<i>Fire Services</i>	<i>\$434</i>	<i>\$62</i>	<i>16.7%</i>	<i>4.0%</i>	<i>(2.3%)</i>
<i>Paramedic Services</i>	<i>\$204</i>	<i>\$39</i>	<i>23.7%</i>	<i>10.2%</i>	<i>3.5%</i>
TTC	\$1,860	\$402	27.6%	13.7%	6.8%
Other	\$2,972	\$356	13.6%	1.2%	(4.9%)
Cost Shared	\$2,743	(\$94)	(3.3%)	(13.8%)	(19.1%)
Total Gross Expenditure	\$11,755	\$1,523	14.9%	2.4%	(3.8%)

Cost-Shared Summary					
Children's Services	\$470	\$92	24.2%	10.7%	5.5%
Long Term Care Homes & Services	\$253	\$33	14.9%	2.4%	(2.4%)
Shelter, Support & Housing Administration	\$677	\$17	2.5%	(8.6%)	(14.2%)
Toronto Employment & Social Services	\$1,099	(\$259)	(19.1%)	(27.9%)	(31.2%)
Toronto Public Health ¹	\$243	\$24	10.8%	(1.3%)	(5.9%)
Cost Shared Total	\$2,743	(\$94)	(3.3%)	(13.8%)	(19.1%)

Other Summary					
Transportation Services	\$388	\$103	36.0%	21.2%	13.8%
Parks, Forestry & Recreation	\$449	\$89	24.7%	11.1%	4.3%
Non-Program	\$677	\$53	8.5%	(3.3%)	(9.2%)
Economic Development & Culture ¹	\$75	\$39	109.6%	86.8%	75.4%
Information & Technology	\$125	\$39	45.7%	29.8%	22.0%
Social Development, Finance & Administration ¹	\$53	\$28	114.4%	91.0%	79.4%
Toronto Public Library	\$193	\$13	7.1%	(4.5%)	(10.3%)
Other	\$1,011	(\$9)	(0.8%)	(10.6%)	(17.0%)
Other Total	\$2,972	\$356	13.6%	1.2%	(4.9%)

¹Changes from 2010 reflect, in part, inter-program transfers related to the Community Partnership and Investment Program.

Summary of revenue growth, 2010 to 2016

Revenue Source (Millions)	\$ Total in 2016	\$ Change from 2010 to 2016	% Change (Unadjusted)	% Change (Adjusted for inflation)
Property tax increase (Council-approved)	\$3,931	\$237	6.8%	(4.8%)
Property tax – cumulative assessment growth	N/A	\$232	6.7%	(4.9%)
Rate-based (Water, Solid Waste & Parking)	\$1,684	\$473	39.0%	23.9%
MLTT	\$527	\$351	199.8%	167.2%
TTC (Fares, ridership growth & other)	\$1,249	\$303	32.1%	17.7%
User Fees, Licenses, Permits	\$609	\$111	22.3%	9.0%
Provincial Uploads (savings)	\$251	\$148	7.3%	(4.4%)
Provincial Transfers ¹	\$1,710	(\$126)	(6.9%)	(17.0%)
Federal Transfers ²	\$155	(\$40)	(20.6%)	(29.3%)
Other revenue sources	\$1,639	(\$166)	(9.2%)	(19.1%)
Total Revenue	\$11,755	\$1,523	14.9%	2.4%

¹ Decline represents lower transfers from decreasing social assistance (Ontario Works) caseload and \$150 million in eliminated funding under the Toronto Pooling Compensation grant.

² Decline represents end of one-time federal funding towards housing affordability programs and declining transfers related to expiring social housing mortgages.

Inflation Rate as measured by Consumer Price Index (CPI), 2010 to 2016

Year	2010	2011	2012	2013	2014	2015	2016
CPI (2016=100)	89.1	91.8	93.2	94.3	96.7	98.1	100.0

Census-estimated population for the City of Toronto, 2010 to 2016

Year	2010	2011	2012	2013	2014	2015	2016 (est.)
Total Population	2,676,148	2,704,622	2,741,169	2,777,211	2,804,604	2,826,498	2,849,110