3
2006 BUDGET ITEMS

(Regional Council at its meeting on December 15, 2005, amended the following report by amending recommendation 8 to read "the Region develop an overall strategy for waste diversion for the Region and the nine local municipalities within the proposed budget;)

(Mayor Taylor declared an interest in the following item due to the fact that his home is registered as a heritage building and receives a heritage tax rebate, and did not take part in the consideration or discussion or vote on the item insofar as it pertained to Non Program Items - Heritage Building Tax Relief)

(Mayor Black disclosed an interest in the following item as it relates to the capital budget for the 19th Avenue Interceptor Sewer project due to the fact that her spouse works for a company that is a sub-contractor on this project and did not take part in the consideration or discussion or vote on this item insofar as it pertained to the capital budget for the 19th Avenue Interceptor Sewer project.)

The Finance and Administration Committee recommends:

(1) the presentation by Regional Councillor D. Barrow, Chair of the Police Services Board, Deputy Chief Eric Jolliffe and Mark Holland, Manager of Financial Services, York Regional Police regarding the 2006 Police Services Business Plan and Budget, be received;

(2) the presentation by Michael Garrett, Chief Administrative Officer and Sandra Cartwright, Commissioner of Finance, regarding the Regional 2006 Business Plan and Budget, be received;

(3) the presentation by Mary-Frances Turner, Vice-President, Rapid Transit Corporation regarding VIVA Service Hours, be received;

(4) the recommendations in the following report, November 21, 2005, from the Commissioner of Finance, be adopted;

(5) the following policy recommendations regarding reductions in the proposed tax levy increase be adopted:

(i) the ratio at which Federal gas tax revenues are to be allocated in 2006 be modified from a ratio of 50% to the operating budget and 50% to the capital budget, to the ratio of 70% to the operating budget

and 30% to the capital budget, so as to reduce the proposed tax levy increase by approximately 0.5%;

(ii) the proposed increase for fuel contingency be reduced from $0.10 per litre to $0.05 per litre, so as to reduce the proposed tax levy increase by approximately 0.1%;

(iii) the budget for 2006 GTA pooling payments be limited to $84.2 million, being a 3% increase on the capped payment agreed to by Council for 2005, so as to reduce the proposed tax levy increase by approximately 1.2%;

(6) the following recommendations regarding service level increases to be included in the 2006 Business Plan and Budget, be adopted:

(i) the VIVA and/or York Region Transit Operating Budget(s) be increased by a total of $500,000, so as to increase the proposed tax levy by approximately 0.1%, and a report be submitted by March 2006 on allocating the $500,000 toward conventional and/or rapid transit and how revenue service hours can be adjusted to meet headway targets;

(ii) the Public Health Budget be increased to provide for the recruitment of the remaining 5.5 FTEs identified as Growth FTEs – High Priority and the position entitled Epidemiologist, Health Info and Planning in the departmental budget explanations provided to the Committee, and that the Commissioner of Finance advise Regional Council at its meeting of December 15, 2005 on the budget and tax levy impact of this increase.

(7) the Region make a limited contribution of $250,000 annually in the years 2006 through 2010 to the Toronto and Region Conservation Authority's Living City Centre project, to be funded from the Capital Reserve, with no impact on the current tax levy;

(8) the Region continue to work on an overall strategy for waste diversion for the Region and the nine local municipalities within the proposed budget; and

(9) staff report to the December 15, 2005 meeting of Council with options for funding activities of the Corporate Clean Air Task Force.

1. RECOMMENDATIONS

It is recommended that:

1. The Region's existing Surplus Management Policy be maintained and that Council not approve a request from the Police Services Board to establish a reserve for the purpose of capturing year-end surpluses.

2. The information contained in this report be referred to budget deliberations.

2. PURPOSE

The purpose of this report is to provide information related to a number of questions arising from the Finance and Administration Committee meeting of November 3, 2005. As these questions were all related to the 2006 budget, a consolidated response format is provided for the Committee's consideration.

3. BACKGROUND

The proceedings of the Finance and Administration Committee meeting of November 3, 2005 included six matters requiring further action.

1. Request from York Region Police Services Board to establish a reserve for year-end surplus
2. Toronto Region Conservation Authority - Living City Centre
3. Budget for Supplemental Taxes
4. Application of Gas Tax Revenues
5. Fuel Contingency
6. GTA Pooling

4. ANALYSIS AND OPTIONS

Following review of the matters noted and the context of the 2006 budget in which the questions were posed, responses and conclusions are noted in the following comments.

Items 4.1 and 4.2 relate to Council's existing policy for Surplus Management and the Region's ability to fund capital expenditures which are not eligible for funding from other sources (i.e. Development Charges). Items 4.3 through 4.6 provide information regarding implications on the 2006 tax levy.

4.1 Police Services Board Request to Reserve Surplus

The Police Services Board has submitted a request for a new reserve to capture year-end surpluses, as outlined in their correspondence dated October 27, 2005. In addition, this request was included in their budget presentation on November 3, 2005.

The Police Services Board letter of October 12, 2005, recommendation 3 states:

> *"That the Police Services Board forward a request to Regional Council for the establishment of a new reserve for the purpose of capturing year-end surpluses."*

The Region's Surplus Management Policy was revised in 2002 and has been the basis for annual recommendations to Committee and Council for the allocation of the year-end surplus to the Region's reserve funds. The reserve funds receiving year-end surplus allocations are the Capital Reserve and the Tax Stabilization Reserve.

The Capital Reserve, established in 1997, shall be used for funding any purpose of the Regional Corporation as may be determined from time to time by Regional Council. The capital reserve shall be operated and maintained from:

- the Regional tax supported surplus as of December 31st in each year;
- appropriations made from time to time from the current estimates of the Regional Corporation; and
- the allocation from such sources of revenue as may be determined by Regional Council.

Examples of projects which have been funded from the Capital Reserve in 2001-2005 are:

Capital Reserve Expenditures	Amount
Purchase Transit Vehicles from Area Municipalities	$5,562,215
Police/Fire Communications	$5,360,863
Solid Waste Management Projects	$3,419,000
Solid Waste Management – Asian Long Horn Beetle Program	$281,635
Land Securement	$1,500,000
IT Capital Initiatives	$12,644,091
HRMFIS Implementation	$1,458,324
Operation Yards – Fleet Additions	$259,331
Daycare Property Renovations	$225,000

The 10-year capital forecast [2006-2015] for York Regional Police includes proposed capital expenditures for infrastructure and equipment of some $139 million. These

expenditures are proposed to be financed from tax levy and debt. Contributions from the Capital Reserve may be considered to reduce debt requirements.
General Government capital expenditures are sometimes recommended to be funded from the Capital Reserve as this is the only fund currently available for these asset management infrastructure/equipment expenditures.

In terms of accountability, sound business practices require realistic budget forecasts to reflect anticipated expenditures and revenues. Ideally, the year-end results should closely approximate the projected budget and not contribute significantly to year-end surpluses.

The Tax Stabilization Reserve, established in 2002, is used to fund temporary tax revenue shortfalls and unforeseeable one-time expenditures. The tax stabilization reserve fund shall be operated and maintained from:

- appropriations made from time to time from the current estimates of the Regional Corporation;
- the allocation from such sources of revenue as may be determined by Regional Council;
- an amount not exceeding 50% of any unallocated year-end surplus; and
- the earnings derived from the investment of monies held in the reserve fund.

This policy has served the Region well in terms of annual contributions to reserves and reserve funds and provides a prudent and judicious financial practice of ensuring reserves are available to support the magnitude of businesses operating within York Region's municipal corporation. In addition, it allows Regional Council the flexibility to be responsive to in-year issues which may arise among any of the Regional departments or boards, requiring funding allocations either within and/or beyond the budget process.

Therefore, it is recommended that the Region's existing Surplus Management Policy be maintained and that the request from the Police Services Board to establish a reserve for the purpose of capturing year-end surpluses be denied.

4.2 Supplementary Taxes

Supplementary taxes arise from new properties (omitted assessment) and property enhancements (supplementary assessment) that have been brought into the assessment base for the Region during the year. This assessment has not been included on the Returned Roll for the year and thus the property tax payable on these properties represents new, and currently, unbudgeted revenue for the Region.

The following table illustrates the historical supplementary tax receipts for the Region from 1999 to 2004.

Table 1
Supplementary Tax Receipts and Write-Offs in York Region

Year	Supplementary Tax Receipts	Write-Offs	Supplementary Tax Receipts Net of Write-Offs
1999	$13.9 M	$1.8 M	$12.1 M
2000	$11.0 M	$2.0 M	$9.0 M
2001	$15.5 M	$4.2 M	$11.3 M
2002	$13.0 M	$5.8 M	$7.1 M
2003	$16.0 M	$7.9 M	$8.2 M
2004	$25.3 M	$5.2 M	$20.0 M

The Property Tax Write-Off Reserve was established in 2000 to absorb the significant and variable annual costs related to property tax write-offs and provide funds for rebates on eligible vacant commercial and industrial properties. Write-offs are dependant upon the amount of reconsiderations and appeals associated with reassessment. This reserve is maintained at $3 million and is funded by the general surplus at year-end. Any surplus funds in excess of the amount needed to maintain the $3 million balance in this reserve are directed to the Tax Stabilization Reserve and the Capital Reserve Fund.

The current Surplus Management Policy takes into consideration the unpredictable nature of supplementary tax revenues, and the need to strengthen the Region's reserves.

In recent reviews by the Credit Rating Agencies, operating results, reserve contributions and fund balances form part of their rating review.

> Moody's Investors Services states, *"York maintains an active reserve policy, setting targets for specific funds, which facilitates planning for future projects and insulates against contingencies and unanticipated occurrences."*
>
> Standard & Poors states, *"York's robust liquidity levels are within the range of 'AAA' rated peers but at the lower end of the peer group range. With capital programs expected to stay at expanded levels for this year and the next two, liquidity levels could continue to come under pressure." "Operating results, which have been declining since 1999, improved notably in 2004 as the region produced a healthy operating surplus of 14% of operating revenues. Operating surpluses have averaged 15% of annual operating revenues from 2000 to 2004."*

Supplementary taxes are not a reliable source of funding. This revenue source is highly dependant on the amount of annual growth and new construction (including capital renovation) within the Region and is therefore subject to the economic cycles associated with the development sector.

Over the past few years, the Region has experienced strong assessment growth which is a direct result of its rapid population growth. Population growth which exceeded 40,000 per year at its peak has slowed down and is expected to be closer to the projected long-term average of 28,000 per year in the future. The number of building permits may start to reduce as the population cycles down towards its normal level. As such, supplementary tax revenue is expected to decline in the future years.

The amount of supplementary tax revenues in any given year is also affected by the timely recording of building permits and the assessment process of the Municipal Property Assessment Corporation (MPAC).

The variability and uncertainty of supplementary tax revenue from year to year would be a considerable challenge to budget accurately. Further, any significant shortfall in the amount budgeted may result in operating deficits and potentially impact on the Region's ability to deliver other programs. Also, if the level of supplementary tax revenues is projected to be reduced in future years, it would become an added budget pressure.

The need to strengthen the Region's capital reserves for infrastructure has been identified previously and will be further discussed in the Long Term Capital Financing Strategy report early in 2006. A key element of this strategy will be to build reserve levels to be sufficient to cover the rehabilitation and replacement of Regional assets, valued at over $5 billion. While at this time, the Capital Reserve benefits from the contribution of annual operating surpluses, the bulk of which is created by supplementary taxes, a future strategy may result in redirecting some or all of that revenue to these capital replacement reserves.

If supplementary taxes become revenue to the operating budget, any benefit would be limited to the first year it becomes part of the base. Subsequent years must maintain the base budget so as not to create a budget pressure. Supplementary taxes are an uncertain and potentially declining source of revenue. Further, if they are used to reduce the tax levy, a major source of contributions to the Capital Reserve will be forgone.

It is recommended that the Region maintain its current policy to allocate supplementary taxes to the Property Tax Write-Off Reserve, the Tax Stabilization Reserve and the Capital Reserve Fund.

4.3 Toronto Region Conservation Authority's Living City Centre

The TRCA's budget presentation included a proposal for funding for their Living City Centre project at the Kortright Centre in Vaughan. The project is valued at $2.5 million and TRCA is requesting that York Region contribute 50% of the total cost or $1.25 million over four years.

The Living City Centre at Kortright is located in York Region in the city of Vaughan. The vision statement for this project is “To engage leadership in bringing the community together to transform greater Toronto into one of the most sustainable, liveable city regions in the world.”

The Living City Centre through its site, environment, facilities and programs will embody and actively promote the principles of sustainable living which links to Vision 2026. The goal statement in Vision 2026 of balancing growth and the environment outlines that the Region will be taking a leadership role in the environmental strategies and conservation.

Generally, capital requests from Conservation Authorities relate to capital projects for water source protection and are funded from the Water Capital Reserve. However, this project does not meet that criterion. This project could be funded through tax levy or the capital reserve. If funded through tax levy the 2006 request of $250,000 would add 0.04% to the 2006 tax levy. Funding from the Capital Reserve would not impact the current tax levy.

York Region has an ongoing partnership with TRCA and has recommended funding excluding the Living City Centre of $3,726,000 in the 2006 budget which includes both the operating levy and capital projects. York Region’s participation in funding the Living City Centre at Kortright would increase TRCA’s ability to leverage funding from various levels of government, other partners, the private sector and community organizations.

An option is to fund the proposal at $250,000 over 5 years, 2006 to 2010. This would adjust the tax levy in 2006 by 0.04% and then become a base item for TRCA’s budget for the next 4 years 2007-2010.

Should Committee wish to support this project, the request for York Region to contribute to the TRCA’s Living City Centre project be considered as a limited contribution over five years from 2006-2010 in the amount of $250,000 annually. This amount could be supported from the Capital Reserve.

4.4 Application of Gas Tax Revenues

The Federal & Provincial gas tax revenues are subject to conditions. As previously reported, the Federal gas tax revenue, administered by AMO and subject to an agreement, is to facilitate investment in environmentally sustainable municipal infrastructure. This includes spending in the categories of public transit, water, wastewater, solid waste or community energy systems. York Region is eligible to allocate funds in any two of these categories. The Provincial revenues are also outlined in an agreement and are subject to conditions. Primarily these revenues must be used for transit systems to improve transit ridership, with continuing receipt being conditional on compliance with the terms of the agreement.

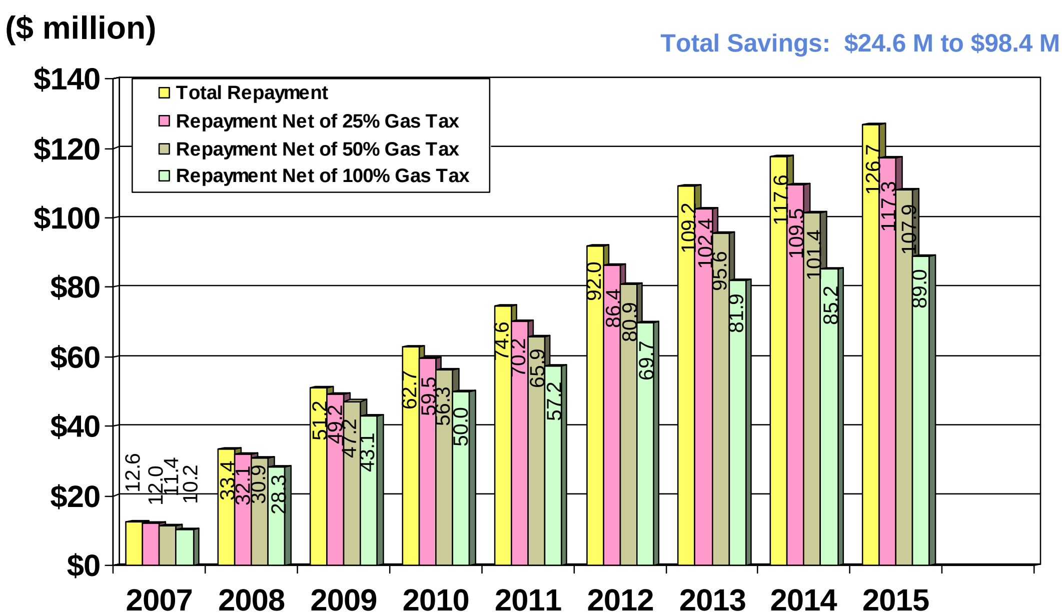
In York Region, investments in new and expanded transit infrastructure have anticipated the new gas tax revenues and as such, these revenues are proposed to be applied to both capital and operating transit expenditures.

The 2006 proposed budget includes gas tax revenue allocation of 50% to the capital budget and 50% to the operating budget. This proposed allocation will allow us to recognize the investment and commitment by York Region to the transit program while meeting and supporting the objectives and conditions of the Federal and Provincial programs.

It should be noted that allocating gas tax revenue to the capital budget effectively reduces the amount of debt required to finance the project; as a result, financing costs are avoided. In allocating to the operating budget, it allows application of these revenues to be applied against debt repayment costs which are effectively the annual payment of capital financing. These are considered as eligible costs which meet the above noted conditions.

This chart illustrates the potential savings resulting from applying 25%, 50% or 100% of gas tax revenues to capital, thus buying down debt.

Potential Transit Principal & Interest
Savings from Gas Tax Revenues



The 2005 Provincial gas tax of $7.7 million has been allocated to capital as referenced in the 2005 budget. With the announcement of the Federal gas tax, the 2005 amount of

$7.1 million along with the Martin/Layton Transit Deal funding of $5.0 million [2005 & 2006 only] are proposed to be allocated directly to capital transit projects.

In conclusion, the 2006 revenue stream of $16.2 million proposed to be allocated 50% or $8.1 million to capital and 50% or $8.1 million to operating is the recommendation of staff. Subsequent year gas tax revenues would follow this allocation formula while continuing to meet the conditions of the respective programs.

4.5 Fuel Contingency

The Region directly consumes some 4.0 million litres of fuel (diesel and gasoline) annually, through its' Roads, Police and EMS business units. Additionally, Transit and Solid Waste Management department's fuel consumption of approximately $10.2 million is embedded within third party service contracts and may experience a 'Fuel Surcharge' cost depending on the final price per litre average at December 31st compared to the contractual rate agreed on by the various contracting parties and the Region.

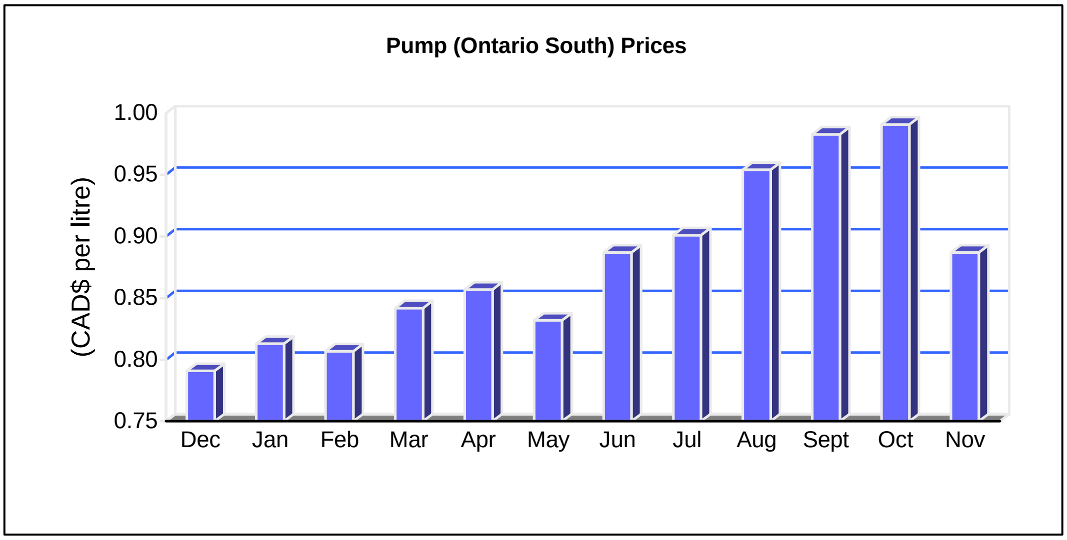
The 2004 and 2005 Regional fuel budgets were $2.5 million and $3.0 million respectively. The 2006 proposed budget is $8.3 million, which includes increased YRT fuel surcharge of $2.1 million (due to the contractual fuel escalation clause and the average price per litre for fuel), new VIVA fuel cost of $300,000 and the contingency of $1.31 million. In addition, the 2006 budget includes an increase of $716,000 due to greater fuel use and $918,000 related to the increased fuel prices (at $0.90 per litre).

Fuel prices are extremely sensitive and prone to high volatility. It is projected that, in 2006, for every one cent change in the price per litre of fuel, the Region's fuel cost changes by approximately $150,000. Given the various forecasts and the volatility in recent times, especially during June to August 2005, the draft budget provides for a contingency of an additional $0.10 per litre to cover potential escalations in fuel costs during 2006.

The price per litre of fuel has steadily increased since the beginning of 2005, a trend which continued from prior years. However, in recent times, the economy has seen large swings in the price per litre for fuel, especially during the period June to August 2005. It should be noted that bulk fuel purchases are made to meet the significant portion of the Region's fuel requirements. This fuel is purchased at wholesale rates, which are less then the pump prices.

During this period a barrel of Crude went from a low of $56.00 US to peak at $72.00 US (a 29% increase, current price is an average of $59.50 US per barrel). Concomitant with this increase in crude prices was a new and erratic movement of prices at the pump. While the prices for crude increased by 29% on average, the price at the pumps was almost doubling ($0.78 per litre to $1.35 per litre).

FIGURE 1

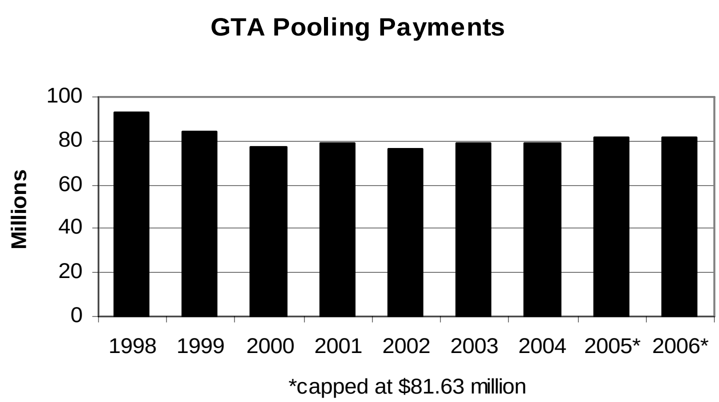


Based on this analysis, the 2006 budget provision of an additional $0.10 per litre to cover escalations in the fuel cost for 2006 as a contingency has increased the budget submission by $1.31 million or 0.2% on the Net Tax Levy.

A provision for a contingency of 5 cents per litre would result in a reduction in the draft budget for fuel contingency of $650,000 or 0.1%.

4.6 GTA Pooling

The implications of reducing the budget for GTA pooling and/or withholding GTA pooling payments was raised during the Committee's budget discussions. The Region's obligation to participate in the pooling of Social Housing and Social Assistance costs with the Regions of Peel, Durham, and Halton and the City of Toronto is the result of the *Ontario Works Act* and regulations pursuant to the *Social Housing Reform Act*. From 1998 to 2004 the Region has made payments of approximately $567 million with its share determined by an assessment based formula.



At its November 3, 2005 meeting, the Finance and Administration Committee also directed that staff report on the implications of potentially reducing the 2006 budget for GTA pooling to an amount equal to the capped payment of $81.63 million.

Staff estimates the 2006 pooling obligations for Social Housing and Social Assistance will be approximately $90.7 million, a 4% increase above the 2005 provincial estimate. This is composed of $45.7 million for Social Assistance and $45 million for Social Housing. However, the final amount may vary from the estimate since the Province may require a year or more following the budget year to finalize its reconciliation.

To reduce the GTA pooling budget to the capped amount would mean lowering the budget by $9.1 million ($5 million from 2005) from the estimated 2006 obligation. Should the Region ultimately have to pay back or make-up the amount being withheld from the Province in 2006, the additional funding may have to come from reserves. Also, the under funding of the GTA pooling budget may have to be made up in 2007 as an added budget pressure.

In previous reports staff has discussed the financial remedies available to both the Province and the City of Toronto, including the report of the Regional Solicitor dated May 6, 2004.

According to the *Ontario Works Act*, unpaid amounts are subject to interest and penalty payments and may also be deducted from amounts payable to the Region under any other program for which the Minister of Community and Social Services is responsible. The report also states that under the *Social Housing Reform Act*, amounts payable become a debt owing to the Crown and may be recovered by any remedy or procedure available by law. Unpaid amounts are also subject to interest of 15% per annum and penalty charges. Furthermore, amounts owing may be set off against amounts payable to the Region under other housing programs.

5. FINANCIAL IMPLICATIONS

The financial implications may vary, contingent on the decisions reached with regard to each of the items addressed in this report. References to each of the six items in this report are noted below.

5.1 Police Services Board Request to Reserve Surplus

By maintaining the Region's existing Surplus Management Policy, Regional Council retains the flexibility to be responsive to in-year issues which may arise among any of the Regional departments or boards, requiring funding allocations either within and/or beyond the budget process. In addition, it provides prudent and judicious financial practices of ensuring reserves are available to support the magnitude of businesses operating within York Region's municipal corporation which are not eligible for alternate funding such as development charges. The prudent use of reserve funds also assists with limiting debt.

5.2 Toronto Region Conservation Authority's Living City Centre

Support of TRCA's request for York Region to contribute to the Living City Centre project could be considered from two perspectives. One consideration is for a contribution over five years from 2006-2010 in the amount of $250,000 annually from the Capital Reserve and therefore would not impact on the current tax levy. A second consideration would be to fund the project through an annual contribution supported by the tax levy for five years. This would have an impact of 0.04% in 2006.

5.3 Supplementary Taxes

To add supplementary taxes as a revenue source to the operating budget would provide a benefit, limited to the first year that it becomes part of the base budget. Subsequent years budgets must then be sustained so as not to create a budget pressure. Since supplementary taxes are an uncertain, unsustainable and potentially declining source of revenue, it is prudent to not recognize them as annual revenue. Further, if they are used to reduce the tax levy in year 1, a major source of contributions to the Capital Reserve will be forgone in the current year and each subsequent year.

5.4 Application of Gas Tax Revenues

Ideally, the allocation of gas tax revenues would be recommended to the capital budget. However, significant investment has been made by Regional Council in support of developing the transit system, while anticipating this revenue stream. The proposed allocation of gas tax revenues equally to operating and capital supports the notion of supporting capital investment. It allows for the direct buy down of future capital financing by applying 50% of these revenues to capital. In addition, it allows for the debt repayment costs to be offset by the allocation of 50% of these revenues to the operating budget. This proposal will allow the allocations to meet the conditions of the Federal and Provincial agreements for these revenues.

5.5 Fuel Contingency

As fuel prices are extremely sensitive and prone to high volatility, it is prudent to provide a contingency to protect against the potential of further price increases. Given the various forecasts and the volatility in recent months, the draft budget provides for a contingency to cover potential escalations in fuel costs during 2006. Based on recognizing potential risk and exposure relating to fuel prices, the opportunity to provide for a contingency while reducing the quantum has been presented for consideration.

5.6 GTA Pooling

Provisions are included in legislation for unpaid amounts which include interest and penalty payments. In addition, any unpaid amounts may also be deducted from amounts payable to the Region. Capping of the GTA Pooling in 2006 may result in added budget pressures in the 2007 operating budget.

6. LOCAL MUNICIPAL IMPACT

The results of recommendations made by the Finance and Administration Committee and ultimately considered for approval by Council will be reflected in the tax levy increase for 2006. The share to each of the nine local municipalities will reflect their share of the Regional levy, based on their pro rata share of assessment.

7. CONCLUSIONS

The conclusions to each of the six matters referenced in this report are contained in the respective sections of the report above. In summary, they are:

1. That the Region's existing Surplus Management Policy be maintained and Council not approve the request from the Police Services Board to establish a reserve for the purpose of capturing year-end surpluses.

2. That the Region maintain its current policy to allocate supplementary taxes to the Property Tax Write-Off Reserve, Tax Stabilization Reserve and the Capital Reserve Fund.

3. An option for the request for York Region to contribute to the TRCA's Living City Centre project be considered as a contribution from 2006-2010 in the amount of $250,000 annually, funded from the Capital Reserve.

4. An option for the allocation of the 2006 gas tax revenue stream of $16.2 million is proposed to be allocated 50% or $8.1 million to capital and 50% or $8.1 million to operating.

5. An option for the fuel contingency is to reduce the provision by 50% or $650,000 [0.1%] which may result in greater exposure and risk during fiscal 2006.

6. The impact of capping GTA pooling at $81.63 million would represent a $9.1 million or 1.6% decrease in the 2006 draft budget, with a subsequent impact on receipt of the provincial revenues and/or an additional 2007 budget pressure.

The Senior Management Group has reviewed this report.