1
LONG RANGE FISCAL PLANNING STRATEGY

The Finance and Administration Committee recommends:

1. **the presentation from Sandra Cartwright, Commissioner of Finance, Tony Haddad, Director, Business Planning and Budgets and Ed Hankins, Director, Policy Risk and Treasury, be received: and**
2. **the recommendations contained in the following report, January 24, 2006, from the Commissioner of Finance be adopted, as amended to include a further recommendation as follows:**
   4. **the development charge discount policy be a priority for early review.**

1. RECOMMENDATIONS

It is recommended that:

1. Council endorse the development of a Long Range Fiscal Planning Strategy with the following components:

   a) A Capital Financing Plan which is based on the long-term objective of maintaining a superior credit rating and includes the following principles:

   - An optimal balance of long-term debt and reserves be established for financing future capital expenditures for growth and improvements; and
   - The use of reserves where possible and appropriate to fund replacement capital.

   b) A Capital Asset Management Plan as set out in Section 4.2 of this report.

2. Staff investigate and report on the potential opportunities and benefits associated with "off credit" project financing for certain major capital projects such as water, wastewater and rapid transit.

3. Council continue to pursue with senior levels of government enabling legislation that would enhance municipal revenue and financing options.

2. PURPOSE

This report deals with the need to develop a comprehensive Long Range Fiscal Planning Strategy to deal with:

1) Near-term and intermediate financing issues relating to the growing use of debt and declining liquidity position due to growth-related infrastructure needs; and

2) An action plan to support the development of a comprehensive Capital Asset Management Plan which will address the rehabilitation and/or replacement of capital assets and the long-term funding requirements to minimize short-term impacts on the tax levy and user rates.

3. BACKGROUND

3.1 Context

Municipalities have traditionally struggled with financing the costs of investment in capital infrastructure. Limited revenue sources continue to challenge municipal budgets and the burden on the property tax levy resulting from needed capital infrastructure investments.

Canada's local government infrastructure deficit has been estimated by the Federation of Canadian Municipalities (FCM) to be in the range of $60 billion. *"Our cities and communities are crucial to Canada's prosperity and global competitiveness. We don't have the resources we need to provide services to our people and maintain and replace our infrastructure."*

The reliance on capital infrastructure has risen in recent years with the rate of growth in various parts of Ontario, technological advancements, the complexity of services today and the growing demand for additional or expanded services by residents. Generally, roads, bridges, wastewater, sewage treatment plants, water treatment plants and traffic networks only attract much public attention when they are failing to serve their intended purpose. However, these essential services support the quality of life in local communities.

Local governments have not been able to afford the costs of maintaining aging infrastructure along with addressing the growing number of responsibilities transferred to them by other orders of government. The results include necessary rehabilitation and/or replacement of capital infrastructure works being deferred, postponed or cancelled due to insufficient funding sources to support the required investment, as well as other local priorities.

This dilemma causes potential impairment of a municipality's competitiveness, economic development and community strengthening initiatives. For those communities competing in a global environment to attract new investment and new industry, the infrastructure deficiency causes undo hardship, additional pressures on the property tax base and in some instances, impedes the priority setting responsibility of local Councils.

In May, 2004, the TD Bank Financial Group commented on the infrastructure deficit. The following references some of those comments, made by Mr. Donald Drummond, TD Bank's Chief Economist at an event sponsored by the Canadian Council for Public-Private Partnerships.

"The current infrastructure deficit facing Canada is a serious hindrance to the country's economic growth and social well-being, but the solution should not come solely from taxpayers. The most stunning statistic was the estimate that Canada's public infrastructure gap sits between $50 billion and $125 billion, which is 6-10 times the level of all current annual government infrastructure budgets combined. This figure is even more telling because governments have been increasing their infrastructure budgets over the past five years."

The TD Bank Report provides some important context for the current problem, answering the questions:

How did Canada fall behind?
What is the economic cost of the problem?

The report cites four major historical trends that led to today's under-funding.

1. *Apart from brief recessions, the Canadian economy has grown steadily and placed added strains on the country's infrastructure, especially in urban centres.*

2. *Infrastructure development was significantly limited, especially when it came to large projects, in the 1980's and early 1990's as governments directed efforts toward deficit reductions.*

3. *Municipalities bore the brunt of both increased infrastructure demand and decreased funding, often with few alternatives but to raise property taxes.*

4. *Poor public policy has resulted in a shortened lifespan for existing assets and further fuelled urban sprawl, raising the average cost of infrastructure.*

As for what solutions may help alleviate the gap, four main recommendations were made:

1. *The user should pay.*
2. *Municipal governments need better tools.*
3. *Get more private sector involvement.*
4. *The federal government needs to play a bigger role.*

Most of the infrastructure deficit is concentrated in Canada's major cities. While mature municipalities are facing challenges relating to capital infrastructure rehabilitation and replacement, growth municipalities are developing new infrastructure in addition to maintaining existing assets.

York Region, being a growth municipality, is faced with both issues, growing infrastructure needs for a growing population and rehabilitation/replacement of existing assets. However, in recognizing these challenges and being responsive to community needs, a strategic, pro-active plan must be developed in order to accommodate the needs of today as well as prepare for the demands of infrastructure rehabilitation and/or replacement in future years. Prudent planning will minimize the impact on operating budgets and the tax levy, reduce the reliance on debt financing and provide a balanced approach to funding new development and also maintaining existing assets.

Since most infrastructure projects take years to plan, deliver and finance, it is extremely demanding on municipalities to fund these initiatives solely on the property tax base. The need today is for federal and/or provincial government support, legislative reform, sustainable funding commitments and a timeframe which addresses the immediate needs of communities. These steps will ensure that municipalities are able to reduce and ultimately eliminate their infrastructure deficit, provide economic benefits, relieve the long-term impacts of aging infrastructure and ensure efficiencies in the operation of the infrastructure supporting municipal programs and services.

While many Ontario municipalities, as well as the provincial government face similar challenges relating to the infrastructure deficit, local approaches to developing plans and solutions to address the long-term aspects of infrastructure management will vary. York Region is unique in as much as it is a growth municipality and has needs for both adding new infrastructure while maintaining the existing assets. The dependency on DCs and debt to finance new infrastructure will shift as development activities taper and we focus more on maintaining the asset inventory.

As we prepare to address these infrastructure needs, we must ensure that a formidable strategy is in place which will guide York Region to ensuring adequate resources are allocated for maintaining the capital asset infrastructure within a funding framework that is both affordable and sustainable over the short and long terms.

York Region has been a leader among Ontario municipalities in many respects and aims to continue to stay ahead of the curve regarding capital infrastructure growth requirements and asset management and the financial framework required to support a sustainable program. The development of a Long Range Fiscal Planning Strategy will address this challenge and continue toward York Region's efforts in being a municipal sector leader, planning for the long-term sustainability of the Region's capital infrastructure assets.

3.2 Capital Financing Program – Current Status

In its 2005 credit rating review, Standard and Poors (S&P) observed that the Region's 'AAA' rating reflected its "record of very strong long-term economic growth, robust liquidity levels, strong long-term operating results, superior taxable assessment growth and prudent financial management."

Moody's Investor Services echoed these views in its review by citing the rating was "supported by a track record of prudent fiscal management, operating positive financial results, an expanding assessment base, high levels of reserves and modest, albeit increasing levels of debt."

In citing these strengths, the rating agencies confirmed the Region's excellent overall fiscal position. However, as S&P goes on to point out in its assessment, the Region's "very large, growth-driven capital spending requirements are leading to a debt burden that is high and rising in comparison with its 'AAA' rated peers."

Given that the Region's capital infrastructure requirements are projected to remain elevated over the next several years, it is important that the Region's fiscal strategy addresses this concern.

Determining an optimal balance of long-term debt and reserves will be a key component of a successful Capital Financing Plan. The implications of not getting it right range from potential credit rating downgrades and higher debt charges and tax levy increases to an inability to access the financial markets to fund critical infrastructure.

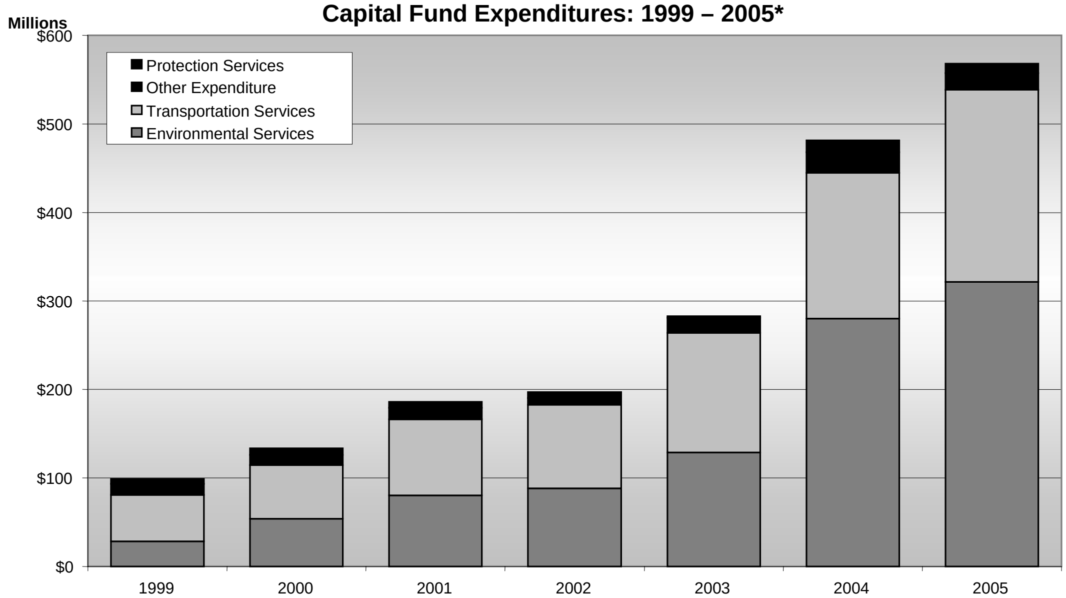
Historically, York Region's debt requirements were relatively modest when compared to its peers. However, for the past several years York's population growth has been one of the highest of any major Canadian city and its economy one of the fastest growing in the country which resulted in both a local building boom and a high rate of taxable assessment growth. In response Council accelerated its capital program in 2003 to start addressing an expanding and largely growth related infrastructure deficit. Corresponding to the ramped up capital expenditures has been an increasing reliance on debt financing.

3.2.1 Trend to Higher Debt Levels

The trend to higher capital expenditures funded by debt is shown on the following two graphs.

Graph 1 shows that capital expenditures have increased more than five-fold, rising from approximately $100 million in 1999 to a budgeted $568 million in 2005.

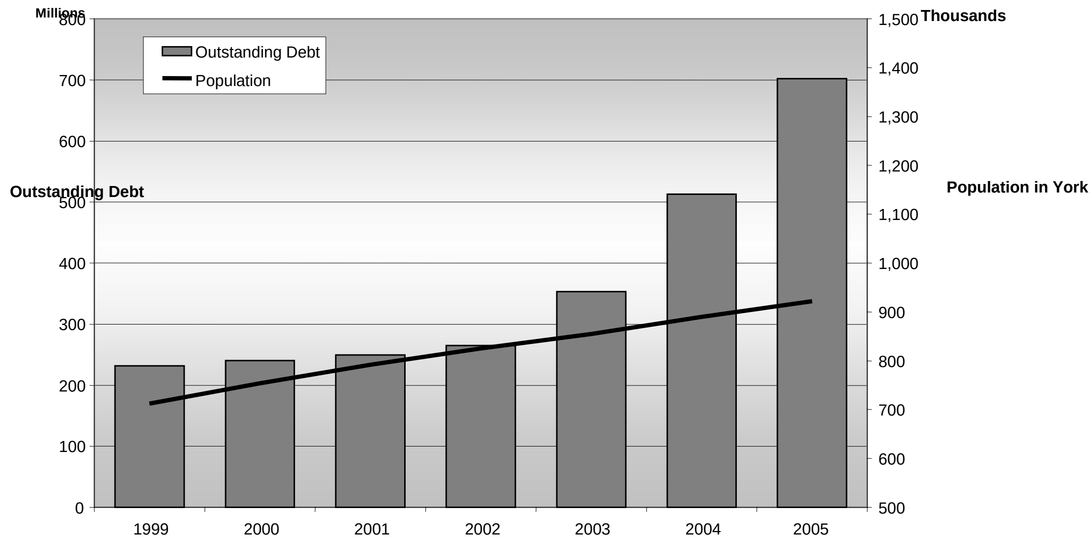
Graph 1
Capital Fund Expenditures: 1999 – 2005*



*excludes $297.5 million in carry forward capital from prior years.

Over the same period long-term debt has been required in addition to direct contributions from reserves and DCs as the main contributor to capital financing. The portion of capital infrastructure financed by debt each year has increased from 14.5% of the total in 1999 to 48.0% in 2005. As a result, the amount of outstanding debt increased from $231 million at the end of 1999 to a projected $702 million by the end of 2005 (Graph 2). The increase in debt has outpaced population growth during this period. On a per capita basis, debt has increased from $325 in 1999 to $762 by the end of 2005. This stems from the need to have major infrastructure such as water and wastewater in place ahead of the new population.

Graph 2
Outstanding Debt & Population

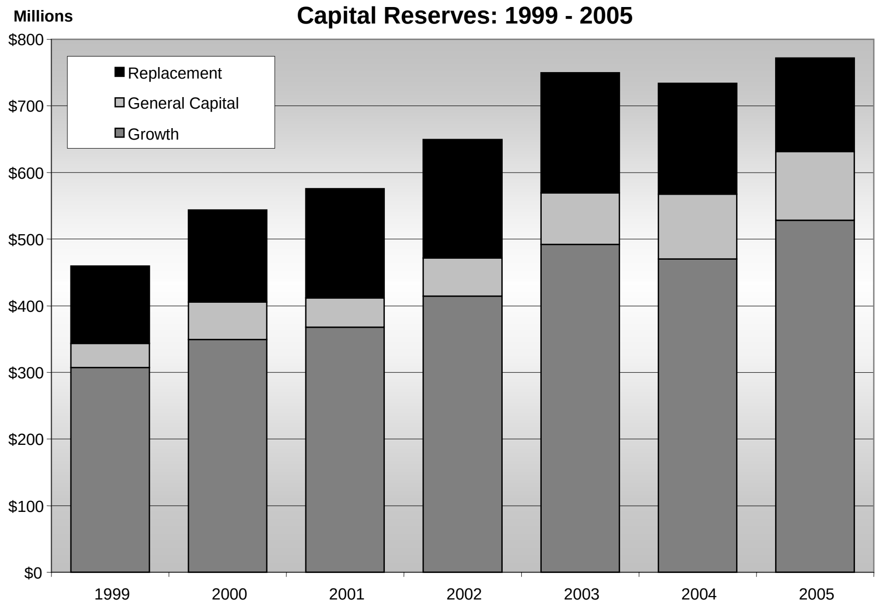


3.2.2 Capital Reserves

Other than debt, the Region uses a number of reserves to fund growth-related, improvement and replacement capital expenditures. Development Charges (DC), although technically classified as deferred revenue by the Public Sector Accounting Board (PSAB), fund the bulk of the Region's growth-related capital and for the purposes of this report is considered as a major reserve. Specific reserves have been established for the replacement of capital for water, wastewater, solid waste, vehicles and buildings. A General Capital Reserve was established to fund unspecified non-recurring capital expenditures not eligible for DC or user rate funding. This reserve is funded from annual contributions from the tax levy through Surplus Management Policy.

Capital reserves form an important component of any Capital Financing Plan as they provide flexibility and liquidity as well as enhance the Region's capacity to handle current and future capital infrastructure needs. For example, they can be used in combination with debt to smooth the peaks in funding capital expenditures from year to year. In addition, they are an effective means to react to diverse market and economic conditions and are consistently cited by credit rating agencies as a major consideration for a municipality's credit rating. Graph 3 summarizes the balances and composition of these reserves over the past 6 years.

Graph 3
Capital Reserves: 1999 - 2005



Contributions to capital reserves come from several sources. DC contributions are made by developers based on capital infrastructure requirements set out in the DC By-law. The water and wastewater rates also include a contribution for replacement capital which was recently updated by Hemson Consulting. The level of contributions needed for the replacement of other major assets is under review at this time and will be reported upon separately. The annual tax levy is the only other major source of contributions to build reserve funds.

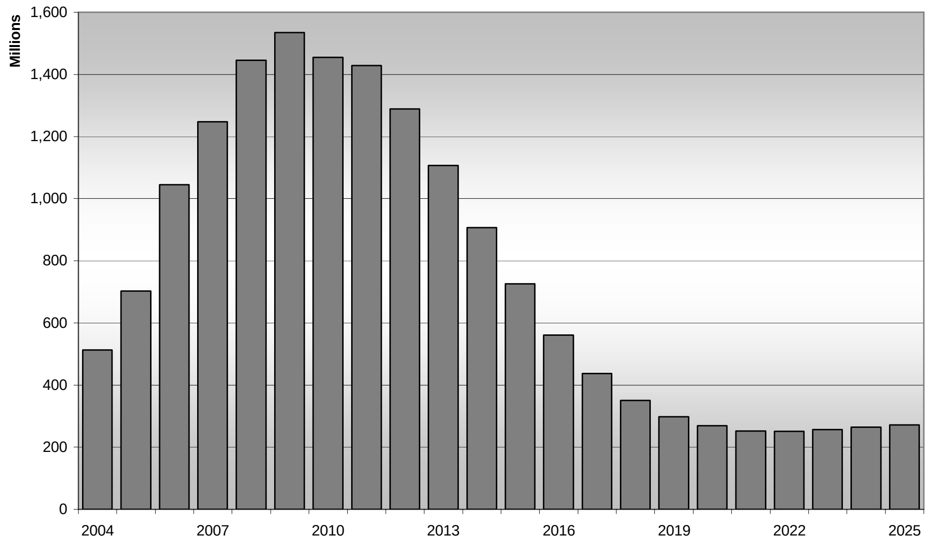
Although Graph 3 depicts reserves as increasing from 1999 to 2005, projected usage to fund infrastructure requirements as contained in the 10-year capital plan will result in lower reserve balances going forward.

3.2.3 Higher Debt/Lower Reserves

Much of the capital infrastructure needed by the Region to meet its growth demands must be built several years in advance of when the actual growth takes place. Examples of this include expenditures for water and wastewater treatment plants and related trunk mains. DCs used to fund these expenditures are calculated based on a planning horizon of up to 25 years in advance. From the time the Region builds the infrastructure until it receives DC revenues down the road, it must finance the cost and bear the risk that growth may not occur as quickly as projected.

Based on the 2005 10-year Capital Plan, the current and the 2005 infrastructure master plans, the Region will continue to rely on the use of debt financing to fund both growth related and replacement capital expenditures over the mid term. Graph 4 shows the projected outstanding debt until 2025.

Graph 4
Outstanding Debt: 2004 - 2025

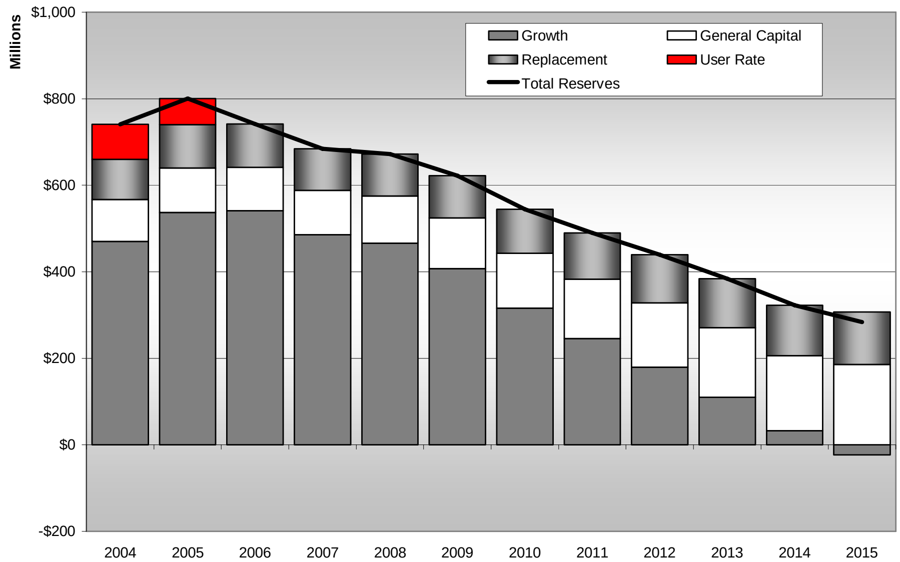


Excluding debt that may be required for Rapid Transit[1], debt financing is expected to average $250 million per year for the next five years and decline significantly thereafter. The outstanding debt will continue to grow over this period and is anticipated to peak by 2009 at over $1.5 billion, approximately three times the 2004 level of $512 million.

At the end of 2005 York Region is projected to have $772 million in total capital reserves. Graph 5 breaks the reserves down for the period 2004 - 2015 by replacement, growth and general capital. Replacement reserves are further divided between rate-supported (water and wastewater) and other replacement reserves (e.g. vehicle, capital asset, social housing, etc.) As Graph 5 illustrates, DC reserves are anticipated to be depleted by 2014 and user rate replacement reserves by 2007 after which future capital will be funded fully by debt until revenue receipts catch up. This again illustrates the lag between the building and financing of the infrastructure versus the DC and reserve fund revenue receipts. With respect to the water and wastewater reserve funds, the projected deficit has been addressed through the Hemson Study approved by Council in 2005. It reflects additional reserve fund contributions required over the next 25 year period. This deficit could be partially mitigated through the elimination of the DC discount as part of the upcoming Development Charge Bylaw review.

[1] It should be noted that at this time costs relating to the future stages of Rapid Transit have not been included in this analysis since Council's commitment to this program is dependant upon contribution from senior levels of government which has not been confirmed. If these costs were included, the need for strategic action would be even greater.

Graph 5
Capital Reserves : 2004 - 2015



The Region's master plans are currently being updated and will be layered over these projections to take them out 20 years. A comparison of reserve balances versus outstanding debt will be provided in a subsequent report based on the impact and master plans.

3.2.4 Comparison with Other Municipalities

Table 1 compares the Region's debt position as at December 31, 2004 with that of similar upper tier municipalities in Ontario and Canada.

Debt per capita and debt as a percentage of operating revenues are important indicators used by credit rating agencies since these encompass both the total amount of outstanding debt in relation to the municipality's size (as measured by per capita) and the ability of the municipality to repay its debt given its income stream.

Table 1
Comparison of York Region's Outstanding Debt
With Other Major Municipalities – Dec 31, 2004

Municipality	Outstanding Debt $ million	Debt per Capita $	Debt to Revenue %	Credit Rating S&P
York	**513**	**577**	**60.7%**[1]	**AAA**
Peel	-	-	0.0%	AAA
Waterloo	124	259	23.8%	AAA
Halton	130	293	29.5%	AAA
Durham	182	312	28.0%	AAA
London	380	1,092	57.0%	AAA
Vancouver	472	837	49.7%	AAA

Average AAA[2]	**300**	**562**	**41.4%**	
Hamilton	277	531	26.0%	AA
Toronto	1,608	616	24.1%	AA
Ottawa	655	775	33.5%	AA
Calgary	1,136	1,217	58.7%	AA[3]
Average AA	**919**	**785**	**35.6%**	
Montreal	3,409	1,815	87.4%	A+

[1] York's Debt to Revenue ratio falls to 55.8% if DC contributions received are included in 2004 revenue
[2] Excluding the Region of Peel
[3] Dominion Bond Rating Service

It is important to note that although outstanding debt per capita in 2004 was approximately equal to the average of the "AAA" rated municipalities surveyed ($562 per capita), the more important debt-to-revenue ratio of 60.7% used by credit rating agencies was higher than the "AAA" rated municipality average of 41.4%.

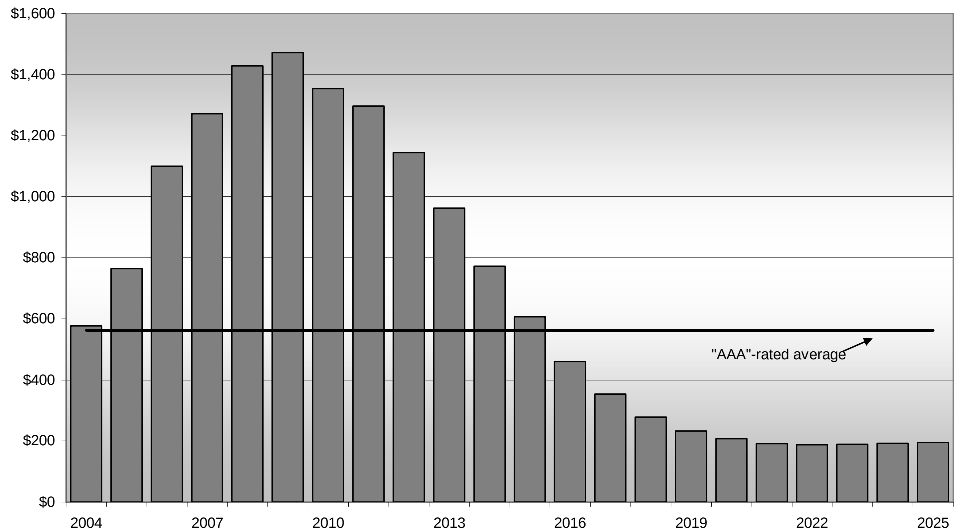
3.2.5 Future Trends for York Debt and Reserve Positions

The following sections illustrate the trends in the key indicators used by rating agencies to evaluate the Region's debt and reserve positions anticipated over the next 10 years.

3.2.5.1 Debt per Capita Trend

Debt per capita is an important indicator used by investors and rating agencies to express the current outstanding debt to the growing size – as measured by population growth - of the Region. Graph 6 shows that York's debt per capita, which was $577 at the end of 2004, will more than double over the next 5 years and peak at approximately $1,450 by 2009 - far outside the range of other 'AAA' municipalities which currently average less than $600 per capita.

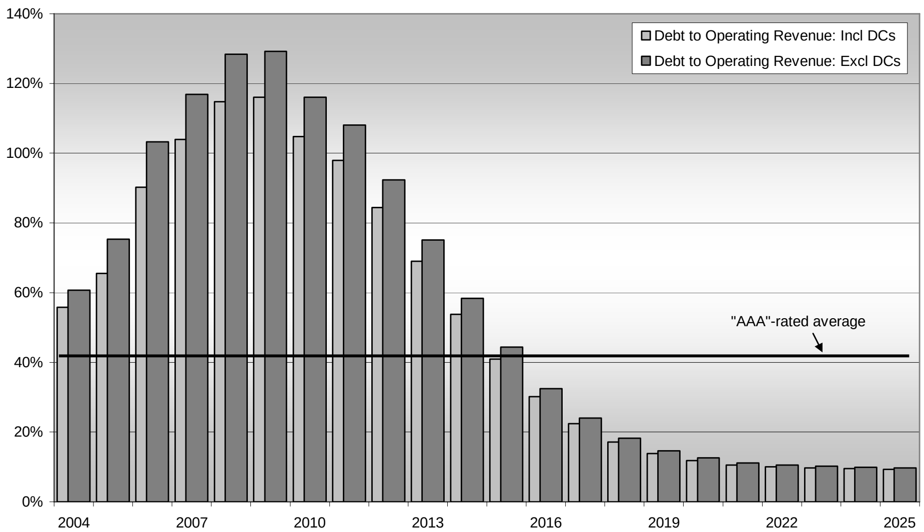
Graph 6
Outstanding Debt per Capita : 2004 - 2025



3.2.5.2 Debt to Operating Revenue

Credit rating agencies use this ratio to determine the feasibility and probability that the Region will generate enough income to repay its debt. It should be noted that credit rating agencies do not include DC receipts as operating revenue since it is a contribution to capital and there is no absolute certainty to this revenue stream. Debt as a percentage of operating revenue is projected to increase from 61% at the end of 2004 to over 125% by 2009 (Graph 7) and will remain well in excess of the average for ‘AAA’ rated municipalities at least until 2015.

Graph 7
Total Debt to Operating Revenue : 2004 - 2025

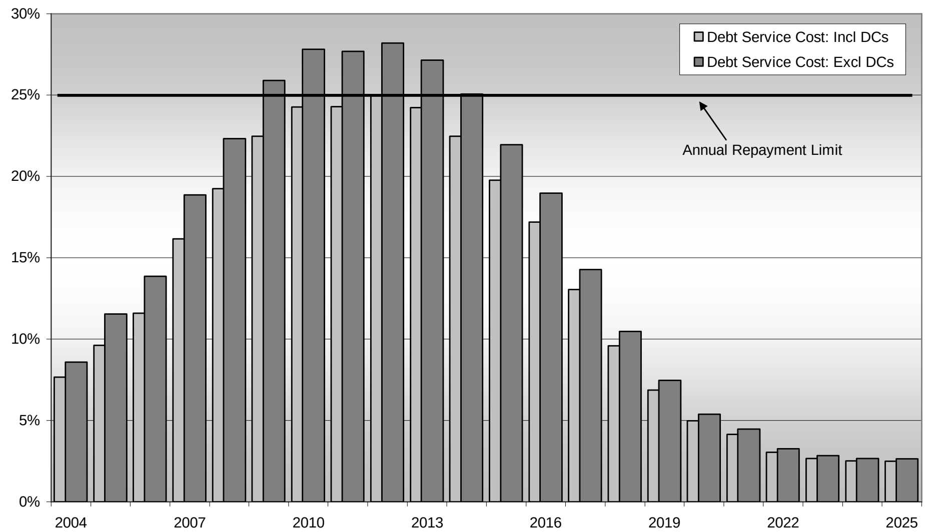


Graph 7 also projects this ratio if DC contributions were included as part of operating revenues. On this basis, debt as a percentage of operating revenue peaks at approximately 116% by 2009.

3.2.5.3 Debt Service Cost to Own-Revenues

The Province calculates an Annual Debt Repayment Limit (ARL) for each municipality in Ontario. Should debt levels exceed this limit, the Region would be required to seek OMB approval for any additional debt financing for subsequent capital projects. As Graph 8 illustrates, projections of debt service costs based on the 10-year Capital Plan will surpass this threshold by 2009.

Graph 8
Debt Service Cost to Region-own Revenues : 2004 - 2025

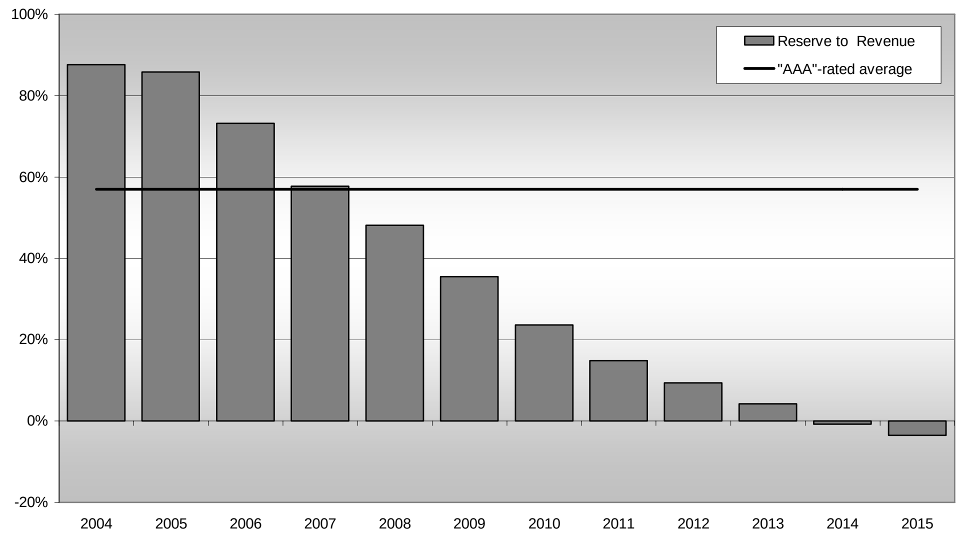


Again, DC contributions are not included as revenue for the purposes of calculating the ARL. Graph 8 further illustrates the impact on this ratio if DC contributions were included as own-source revenues. Under this scenario, debt service costs stay within the threshold level of 25%.

3.2.5.4 Capital Reserve Trend

In addition to debt commitments, rating agencies focus on municipal liquidity levels, i.e. the amount of reserves (capital reserves in particular) a municipality maintains. An important benchmark used by the rating agencies is the level of capital reserves to operating revenues and the Region’s 10-year forecasted trend relative to this benchmark is depicted on Graph 9. Although the Region’s capital reserves currently significantly exceed the average of other ‘AAA’ municipalities, this advantage is forecasted to erode and could be well below its peer group by 2007 and actually fall into a deficit position by 2014. One mitigation for this will be the strategy for the Region’s infrastructure replacement which will be brought forward in future reports.

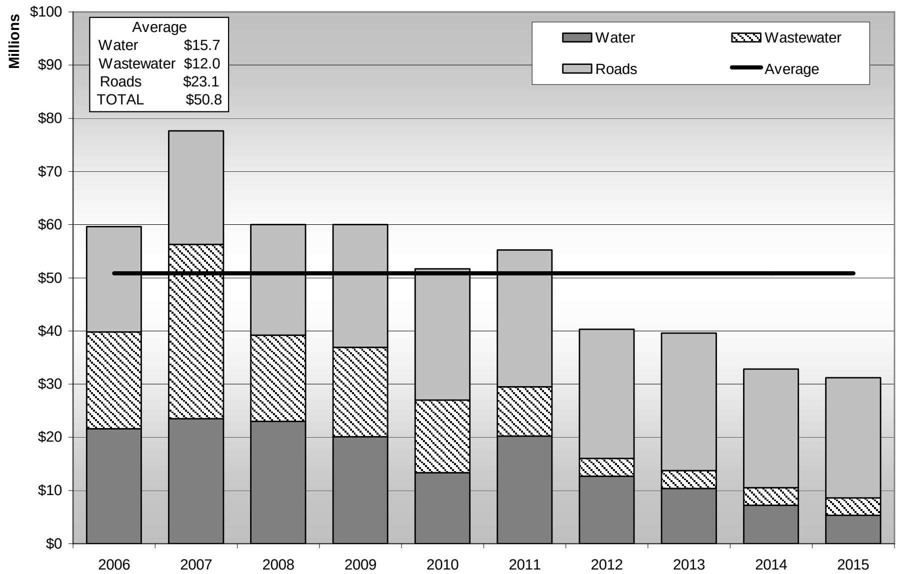
Graph 9
Capital Reserves to Operating Revenue : 2004 - 2015



3.2.5.5 Discounts

The current policy of discounting DCs on certain water, wastewater and roads infrastructure has a significant impact on the Region's Capital Financing Program. These discounts which amount to approximately 20 percent of DC rates are forecasted to average over $50.8 million per year, $27.7 million water and wastewater and $23.1 million roads, over the next 10 years. Graph 10 projects the amount of these discounts to 2015.

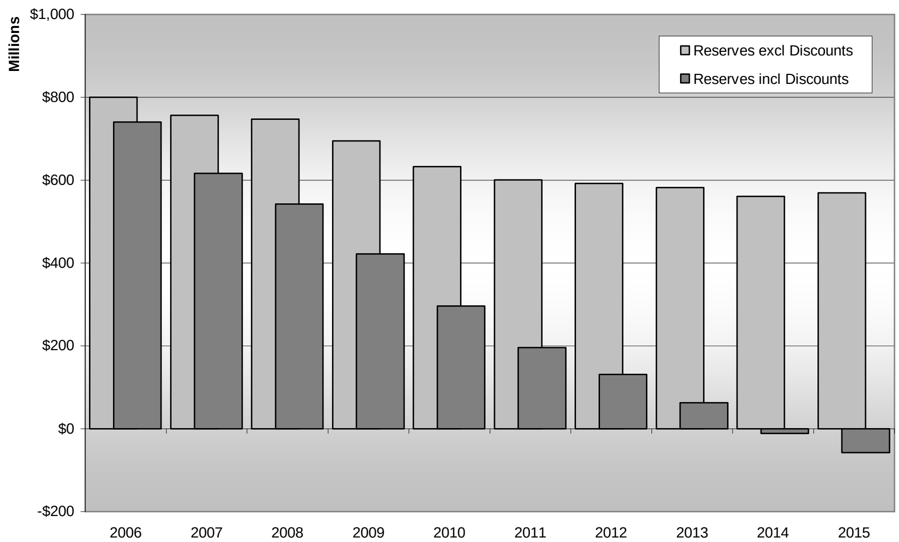
Graph 10
DC Discounts: 2006 - 2015



If these discounts were eliminated the Capital Reserves would increase significantly. Graph 11 compares the projected capital reserves with and without DC discounts.

Further consideration must be given to the reduction and/or phase-out of the DC discount. This matter will be addressed in subsequent reports, proposing policy amendments on the broader aspects of the Long Range Fiscal Planning Strategy.

Graph 11
Capital Reserves : 2006 - 2015
With and Without DC Discounts



3.3 Principles for Developing Capital Financing Plan

The Capital Financing Plan will address the short term (i.e. 8 to 10 year) pressures and the longer term stabilization of debt levels. When developing an appropriate Capital Financing Plan, staff will draw upon two financial policies which have been approved by Council.

The Financial Mission Statement was adopted by Council in 1998. A key principle contained in it states "Capital financing and debenture practices will be responsive and fair to the needs of both current and future taxpayers and will be reflective of the underlying life cycle and the nature of the expenditures."

The Capital Financing and Debt Policy (the Policy) was approved by Council in January 2003. The Policy details the Region's financing objectives, in order of priority as:

- Adhere to statutory requirements;
- Ensure long-term financial flexibility;
- Limit financial risk exposure;
- Minimize long-term cost of financing; and
- Match the term of capital financing to the useful life of the related asset.

The Policy states that by successfully fulfilling all of these objectives, the Region can expect to maintain its superior credit rating. The goal of the Policy therefore, is not to eliminate the use of debt as a means of capital financing, but to ensure it is used appropriately to meet Council's objectives.

Based on these policies, staff will use the following two principles when developing a proposed Capital Financing Plan. First, an optimal balance of long-term debt and reserves needs to be used when financing future growth and/or improvement related capital infrastructure. Second, reserves should be used where possible and appropriate to fund replacement capital.

3.4 Need for Capital Asset Management Plan

The need for a capital asset management plan to establish a long-term plan for the rehabilitation and/or replacement of capital assets and the associated funding requirements has been identified as an essential element of a Long Range Fiscal Policy Strategy.

In addition, the Canadian Institute of Chartered Accountant's (CICA) Public Sector Accounting Board (PSAB), which is responsible for setting the accounting and financial reporting standards for all levels of government in Canada, initiated a research report titled Accounting for Infrastructure in the Public Sector, which was released in 2003.

The study group that produced this report conducted extensive reviews of international and Canadian practices of accounting for capital assets in both the private and public sector. They concluded that there are various benefits to providing information about capital assets but, at the local level, there is a significant gap between the financial information management and municipalities need to manage their capital assets, and the information they currently receive.

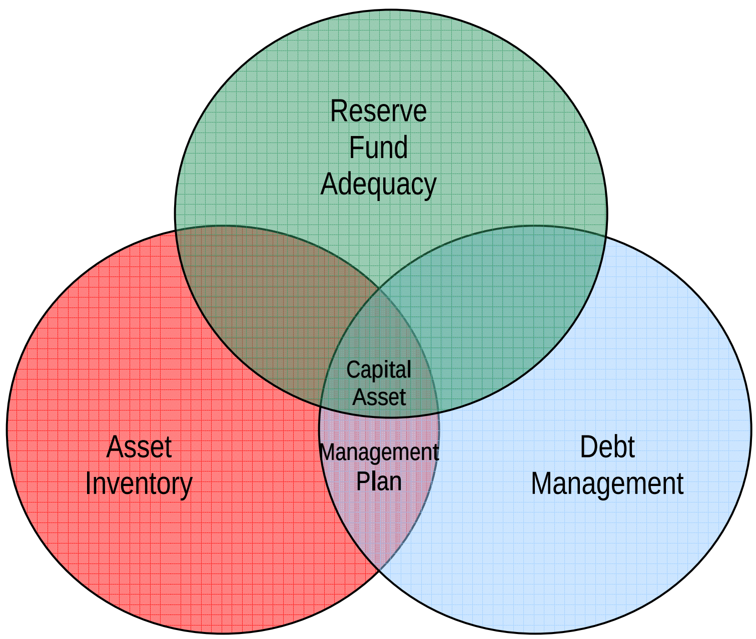
If the cost of using infrastructure is not reported, that cost cannot be taken into account and municipalities cannot adequately exercise their stewardship responsibilities. Further, without understanding the future maintenance and replacement costs associated with infrastructure, municipalities cannot easily assess whether they can afford to maintain existing programs or expand both the type and quality of those programs.

It is expected that the PSAB Task Force on the Financial Reporting Model for Local Government will consider the conclusions of the study as part of the current review. Recording capital assets in the financial statements is the last hurdle to bring local government financial statements to full accrual accounting basis. The PSAB proposed reporting model will ensure greater transparency in financial reporting for capital assets, and highlight the previously unreported infrastructure funding gap. Since Canada's senior levels of government now report capital assets in their financial statements, it is expected that PSAB will recommend the extension of this reporting to local governments by 2006 and will require capital asset accounting by 2008.

To ensure that the repair and eventual replacement of assets is adequately provided for, public sector entities should manage capital infrastructure assets using an asset management system and should include the following actions:

- Maintain an up-to-date inventory of capital assets
- Perform periodic condition assessments of capital assets
- Summarize the results using an appropriate measurement scale
- Estimate the annual amount required to maintain and preserve the capital assets at the condition level established by the entity
- Determine the appropriate balance of debt and other financing sources to be used to support the management of capital assets

The relationship between the above-noted tasks that forms the basis of a capital asset management strategy is depicted in the following chart.



The asset inventory is the basis to determine valuations of existing assets and must be maintained to ensure new asset acquisitions are added with their respective value and life cycle. The inventory is one component of the asset replacement strategy.

PSAB requirements for financial reporting will be addressed separately, based on the reporting criteria eventually adopted. However, there are likely to be some overlaps of data which will complement this reporting requirement and thus eliminate further work being necessary

4. ANALYSIS AND OPTIONS

4.1 Capital Financing Plan

4.1.1 Implications of Current Financing Trends

The amount of debt incurred today and in the past has a lingering or legacy effect for many years to come. Similarly, depletion of capital reserves could negatively impact a municipality's liquidity position. Issues that can potentially arise if debt reliance were to go on unabated or if liquidity levels were perceived to be inadequate, include:

- Credit rating downgrade(s);
- Breach of provincial Annual Repayment Limit; and
- Difficulty accessing capital markets.

4.1.1.1 Credit Rating Impact

Credit rating agencies look at many variables when assessing a municipality's credit worthiness including strength and health of local economy, demographics, fiscal management and political structure/environment. York Region has demonstrated these strengths. However, particular focus is placed on debt and liquidity levels.

As previously indicated, benchmarks which the credit rating agencies use to evaluate a municipality's credit worthiness relating to debt include:

- Outstanding debt obligations as a percentage of operating revenues.
- Debt per capita compared to peers.
- Reserves available to finance capital as a percentage of operating revenues.

As the Region takes on more debt and/or utilizes more of its reserves, it increases its risk of underperforming these benchmarks and jeopardizing its superior 'AAA' credit rating.

Standard and Poors, in its most recent review of the Region's credit rating, made specific reference to the Region's debt as a percentage of operating revenues when it cited that:

"The negative outlook reflects the expectation that York's burden of debt could continue to rise and reach levels that are well outside of its 'AAA' rated peers within the next two years. Accordingly, if the Region fully implements its current approved capital plans and debt issuance intentions in 2006 and 2007, the ratings could be lowered. The establishment of a trend that would return York's debt burden (measured as a share of operating revenues) to 2004 levels or below, however, could lead to the outlook being restored to stable."

4.1.1.2 Annual Repayment Limit (ARL)

The Province's ARL is set by regulation at 25 percent of a municipality's own source revenues.

Current projections show that the Region's ARL ratio will increase from almost 9% in 2004 to 28% by 2009. Approval from OMB will be required for any subsequent capital project if the 25% target is exceeded which will also send a negative signal to credit rating agencies and potential investors.

As previously noted, the Province does not include annual DC contributions as operating revenue when calculating the ARL. DC revenues represent a significant source of funds for the Region and if these were included, the Region's ratio would decline from 28% in 2009 (the peak level) to approximately 25% (see Graph 8).

4.1.1.3 Access to Capital Markets

The Region typically borrows long term funds through the sale of debentures. Buyers of these debentures, which include life insurance companies, pension funds, investment managers, other municipalities, government agencies and private individuals, place great reliance on a municipality's credit worthiness as assessed by the various credit rating agencies. Any major downgrade(s) may preclude certain key investors from buying Region of York debentures, limiting its ability to access large quantities of debt in the future.

4.1.2 Methodology

The issues involved in the development of a Capital Financing Plan are both complex and diverse in nature. The use of debt, adequacy of reserves, availability of tax and user rate revenues are all important components of such a plan. Staff will need to do significantly more work and analysis in a co-ordinated inter-departmental way in order to determine viable financing options.

Analysis and plan recommendations will need to consider the following:

1. Debt issuance focusing on:
   - projected debt requirement
   - limits and benchmarks
   - impact on credit rating
   - term and structure of debt
   - impact of deferral of certain capital projects
   - use of reserves to offset debt issuance
2. Reserves usage focusing on:
   - availability and adequacy
   - asset replacement needs and external consultants reports
   - projected DC contributions and review of discounting policy
   - impact on tax and user rates – Hemson Study
   - potential use of reserves to offset debt issuance
3. Tax and user rates focusing on:
   - contribution to reserves
   - pay-as-you-go capital requirements

4. Other considerations such as:
    - application of federal and provincial gas tax revenues
    - rapid transit initiative
    - off balance sheet / "off credit" debt alternatives (Watertight)
    - tax incremental financing

4.1.3 Off-Credit Financing Opportunities

Given the additional pressures on capital spending, the Region might consider some off-credit financing options. These alternatives will most probably be channelled through the creation of municipal business corporations. By establishing a special purpose entity or corporation, the Region could potentially transfer debt related to the capital assets of that corporation off its books thereby reducing its overall debt obligations. Currently, this option is only available for new transit outlays, but could soon be extended to water and wastewater. A utility-based corporation could potentially have the ability to lease or own water and wastewater assets and be able to borrow on its own behalf. By removing current and future debt designated as water and wastewater (i.e. transferring off credit), the Region's debt commitment would be dramatically reduced. These options could be used with other alternatives such as Tax Increment Financing (TIFs).

However, the impact on the creditworthiness of the Region, the guarantees that may or may not be required to be put in place and the impact on the Region's revenues need to be studied in more detail before an informed recommendation can be made.

4.2 Capital Asset Management Plan

The Region's capital assets must be supported by contributions to reserves to address their eventual rehabilitation and/or replacement. The assets to be replaced include: those funded by DCs, reflecting the significant levels of growth within York Region; the 'growth' capital assets which were partially funded by tax levy and user rate as a result of the DC discount policy; and new 'non-growth' capital assets which are not supported by DCs.

York Region's total capital asset inventory has a preliminary estimated value of approximately $6.3 billion. The estimated useful life of these capital assets range from 3 years to 100 years.

The two common sources of financing for non-growth assets are capital reserves and debt, both of which are funded through the tax levy and/or user rates. As previously stated, a critical component of the Capital Asset Management Plan is to determine the appropriate levels of reserve funds required to support the planned rehabilitation and/or replacement program for capital assets. Once established, the development of a long-term funding strategy is necessary to meet the required reserve fund levels through annual contributions and allocations.

In a report to the Finance & Administration Committee on November 3, 2005, reference was made to the Region participating in a pilot project with Ontario Municipal Benchmark Initiative (OMBI) regarding fixed asset accounting. In addition, it was indicated that subsequent events on this subject would include:

- Determine appropriate reserve fund levels to address replacement/rehabilitation of major capital assets.
- Develop long term strategy to meet reserve fund adequacy levels.

The need exists for the development of a Capital Asset Management Plan to better position the Region to address the required reserve allocations and contributions to ensure that the investment in capital assets is appropriately protected and managed on a long term basis. The current level of commitment to capital asset replacement reserves is clearly inadequate. Therefore, the completion of a Capital Asset Management Plan will result in a plan to ensure the availability of funding to replace capital assets as their expected life cycle concludes.

At its meeting of June 23, 2005, Regional Council endorsed the development of a proposal to be submitted for consideration of York Region as a pilot site for the Accounting for Capital Assets project sponsored by the Ontario Municipal Benchmarking Initiative (OMBI). The Region's proposal has been approved, with a focus on the Roads program which represents a significant element of the capital infrastructure assets. This pilot project will take approximately one year to complete and has already commenced.

Subsequent components of this strategy will be to:

- determine a methodology for valuating and depreciating assets
- identify sources of funding for reserve contributions
- determine appropriate reserve fund levels to address replacement and rehabilitation of major capital assets
- develop a long term strategy to meet reserve fund adequacy levels
- propose a phase-in plan for implementation of the strategy
- development of a revised debt management policy

4.2.1 Methodology

In establishing a plan for managing capital assets, the Region must undertake the following tasks:

- Determine the value of existing capital asset inventory
- Layer anticipated new assets based on 10 year forecast and Master Plans
- Determine annual contribution required for replacement and/or rehabilitation of capital assets
- Establish when funding for capital asset replacement commences -
    - Immediately, or

    - Following debt retirement, or
    - 25% - 50% into life cycle, or
    - Other
- Establish reserve fund requirements
    - ideal minimum and maximum contributions from reserves
    - balances to be maintained
- Establish maximum debt financing levels
- Other considerations

4.2.2 Capital Asset Inventory

The asset mix within the Region's inventory of capital assets includes the following classes of assets. Within each class there are related components.

- Major Infrastructure
- Linear water and wastewater assets
- Discrete water and wastewater assets
- Buildings
- Rolling stock
- Major equipment
- Technology Equipment

The preliminary results of the asset inventory, as at December 10, 2005 reflects the values as illustrated in Table 2:

Table 2
Inventory of Existing Regional Capital Assets
As at December 2005

Asset Class	**Range of Useful Life (years)**	**50 Year Life Replacement Cost ($billions - 2005)**
Linear Roads	15 & 40	1.8
Discrete Road Assets	7 - 75	0.6
Linear Water & Wastewater	100 & 75	0.2
Discrete Water & Wastewater Assets	50 & 30	1.5
Other Program Specific Facilities	25 - 50	0.6
General Buildings	25 - 50	0.2
Rolling Stock	3 - 18	0.8
Other Assets	3 - 25	0.6
Total		**$6.3**

The replacement value of these capital assets is approximately $6.3 billion, based on a combination of actual costs, asset valuations and insurance valuations. Moreover, the long-term capital forecast indicates that approximately $8.0 billion in new capital assets could be added to the Region's capital asset inventory by 2026.

At this time, approximately $173.0 million in reserves are dedicated for the replacement of assets. The operating budget currently includes a provision for annual contributions of approximately $16.0 million to capital asset replacement reserves. This level of commitment is inadequate and supports the need for the development of a Capital Asset Management Plan to better position the Region to address the required reserve allocations and contributions to ensure that the investment in capital assets is appropriately protected and managed on a long term basis.

4.2.3 Water & Wastewater

The Region's uniform water and wastewater user rates provide funding for the following:

- rehabilitation and replacement of existing assets
- rehabilitation and replacement of assets to be built in the future
- new infrastructure and upgrades for the non-growth component of DC supported development
- growth related infrastructure not recovered from DCs due to reduced DC rates [discount]
- costs associated with operating water and wastewater service facilities

A component of the user rate is contributed to a capital reserve to fund the above noted capital requirements. The firm of Hemson Consulting has recently completed an analysis of water and wastewater user rates and reserve fund requirements to 2031. Commencing with the 2006 budget, increased contributions to reserves will be made to ensure future rehabilitation and replacement needs are met. These contributions are reflected in the revised rate structure approved by Council as part of the 2006 Budget.

This analysis represents the beginning of a process required to assess the Region's entire inventory of capital assets and determine reserve fund contributions required to meet future rehabilitation and replacement needs. As such, further work is required to complete the assessment of the remaining classes of capital assets. This work is expected to be complete by February, 2006.

4.3 Opportunities

Much of the new capital asset inventory is being funded by debt, supported by DCs. However, the non-growth component is supported, in part, by tax levy and user rates. The retirement of this debt in future years provides the capacity in tax room to direct allocations to reserves without adding additional pressures to the tax levy. This presents an opportunity to commence addressing the needed reserve fund allocations in a planned manner. In addition, future operating budgets, commencing in 2007 should include increased contributions, once again, in accordance with the strategy to be developed, so as to mitigate the inadequate reserve fund levels to support the capital asset inventory.

4.4 Next Steps

Based on the above noted principles the Region's current status relating to the capital asset inventory is significantly under-funded. Therefore, a strategy to address this situation is recommended. The strategy must recognize that certain limitations may require a long-term phase-in of such a strategy. Regardless, we must commence to address this matter to protect the capital asset inventory, begin to make meaningful contributions to reserves, manage within the limitations of tax rate tolerance and provide a framework which can be revised as conditions change or opportunities arise which may impact on the strategy.

The following steps need to be taken to develop the Long Range Fiscal Planning Strategy.

- Capital Asset Inventory – substantially complete
- Debt Management Plan
- Layering 10-year Capital Plan, Master Plans
- Capital Asset Replacement Financing Plan
- Reserve Fund Adequacy Plan

It should be noted that the Region is participating in a one year pilot project for OMBI pertaining to accounting for fixed assets. The Region's road inventory will be the focus areas of this pilot. The results of this project will greatly assist the Region in its implementation of an asset management plan.

5. FINANCIAL IMPLICATIONS

5.1 Debt and Reserves

Trends relating to the increase in the Region's debt levels and depletion of its reserves projected in the current 10-year Capital Plan could pose a risk to maintaining the Region's 'AAA' credit rating. The direct costs of any potential downgrade are unknown at this time. Determining these costs, however, will form part of the analysis to be included in a subsequent report addressing the Capital Financing Plan.

Issues such as DC discounts, Gas Tax revenues and legislative reform of DC issues represent options for consideration to mitigate the challenges facing York Region and potentially relieve some of the burden on the property tax base.

With policies for reserves, pay-as-you-go and debt to finance capital projects, we must also ensure sustainability and stability in terms of the impact on the tax levy and user rates.

The projections for York Region excludes any commitment to the future phases of Rapid Transit as this project is contingent on pending funding commitments from Federal and Provincial governments. The estimated cost of the next phase of this project is approximately $1.5 billion of which Council has approved one third of the funding conditional upon two thirds of the funding coming from senior levels of governments. This additional funding could eventually add substantial pressures on debt levels.

The 2006 budget has allocated shares of the Federal and Provincial Gas Tax Revenues to both the Operating and Capital budgets on a 70:30 basis. Future revenues from this source are projected to increase and allocations are projected to be allocated to capital programs. This policy will be addressed in the next report and reflected in the financial projections.

5.2 Capital Asset Replacement

As current allocations and contributions to reserves for capital asset rehabilitation and replacement are inadequate, a plan to fund replacement of existing and future capital assets will be developed to address the contributions required to reserves. A long range plan will be developed covering a 50 year time horizon in recognition of the life cycle of some of the major infrastructure assets. A plan is necessary to address this matter and develop a proposed long range solution commencing in the 2007 budget.

Both short-term and long-term funding options will be developed to contribute to reserves. The short-term plan should focus on the existing assets and a long-term plan would address the new assets to be acquired.

The Hemson Study has addressed water and wastewater capital assets. Their recommendations included amendment to the contribution to reserves over the next w25 years based on consumption. This takes into consideration the required funding for these infrastructure assets.

Recommendations for the current shortfall in replacement reserves for existing assets will be addressed in a phased manner to close the gap on reserve requirements. For new capital assets, a methodology will be determined which will take into account the term of debt and appropriate timing of the commencement of reserve contributions.

The result of these two steps provides the framework to establish and maintain adequate reserves consistent with the existing capital assets inventory and future acquisitions.

Among the next steps in the development of the capital asset management plan will be to present further reports on the major components necessary to support such a plan, funding methodologies to consider and options to achieve improved funding levels for reserves.

6. LOCAL MUNICPAL IMPACT

As area municipalities are required to borrow under the Region's name, they therefore benefit from its ability to borrow on a cost effective basis due to its 'AAA' credit rating. Any rating downgrade, therefore, would increase the costs of borrowing for area municipalities as well as the Region.

The development of a Long Range Fiscal Planning Strategy will allow for planned contributions and allocation to reserves to address the future rehabilitation and/or replacement of capital assets. This strategy should result in a smooth impact on the annual tax levy and minimize the creation of additional tax levy pressures on the local municipalities.

7. CONCLUSION

The Region, like most Canadian municipalities, shoulders responsibility for the replacement and rehabilitation of capital assets in the absence of adequate and sustainable funding from the federal and provincial governments. This is not a position of strength, nor can it continue in light of the growing infrastructure deficit.

Further, growth municipalities face the compounding effects with the addition of new infrastructure while maintaining existing assets.

Sources of funding are the tax levy, water and wastewater rates and DC's. Constraints of the DC Act pose a burden to the tax levy and rates. Consequently, lack of senior government funding for major infrastructure, such as public transit, presents a fiscal challenge.

The challenge of addressing the infrastructure deficit must be addressed by all levels of government to ensure the infrastructure deficit is eliminated and managed into the future.

Capital infrastructure needs over the past few years and those anticipated over the intermediate term will stretch the Region's capital financing capabilities to critical levels. If left unchanged, York Region's outstanding debt levels and associated servicing costs could trigger a credit rating downgrade. Any changes to York Region's credit rating would result in increased costs and may also hinder its ability to borrow on an effective basis. Plans to mitigate this outcome will need to be developed in a co-ordinated and timely manner.

The development of a Long Range Fiscal Planning Strategy will continue with updates to Committee and Council during 2006. The development of this strategy will focus on the following critical components: a capital financing plan, a reserve adequacy review, as well as a capital asset management plan. Issues to be addressed by these plans include:

- Debt versus reserve usage to finance future capital infrastructure;
- Adequacy of reserves for future capital asset replacement and refurbishment;
- Impact on tax and user rates;
- Other considerations such as “off-credit” financing.

The objective is to adopt the strategy and commence allocations and contributions in the 2007 budget in order to address the reserve fund levels required to support the Region’s capital assets and avoid a deficit in the provision for future infrastructure rehabilitation and replacement while maintaining the Region’s outstanding debt commitments at fiscally appropriate levels.

The Senior Management Group has reviewed this report.