City of Ottawa

Long-Range Financial Plan:

First Steps

2002-2011
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Financial Services Branch
Corporate Services Department

Shaping our future together
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Executive Summary

The Long-Range Financial Plan: First Steps offers a financial outlook for the City of Ottawa over the next ten years. The report was prepared at the request of City Council, and is intended to increase understanding of solutions to the challenges the City faces as it grows, and to present a number of approaches for City Councillors to consider as they determine what we can do to manage growth in Ottawa in order to continue to provide high quality services to residents.

Cities have always been centres of economic activity and growth. With the advent of free trade, cities have become key drivers of national economies, and investments in municipal infrastructure provide significant benefits to communities beyond urban boundaries. In Canada, more than 60 per cent of Canada’s total employment growth over the last four years has occurred in just ten urban regions.

Ottawa is one of the most desirable cities in Canada in which to live. Over the past 20 years, the City has seen its population grow by a staggering 41.6 per cent. These people, in turn, have propelled significant economic development in the City -- Ottawa has enjoyed strong employment creation between 1993 and 2001, averaging 3.5 per cent growth each year. In 2001, the number of new jobs peaked at 28,000.

At present, the City receives an estimated seven cents of every new tax dollar generated here, with federal and provincial governments receiving 93 cents. It is not reasonable that cities should be required to pay over 80 per cent of the costs of growth infrastructure with only 7 per cent of the revenue generated from this growth.

Every effort has been made to meet the needs of the City within the current framework. Indeed, most Ottawa taxpayers have seen their property taxes frozen or cut for eleven consecutive years. When adjusted for inflation, the average urban resident now pays 20.5 per cent less in property taxes than in 1993, and the average rural resident pays 21.9 per cent less.

Amalgamation has placed the City in a stronger position to meet the challenges it faces. By collapsing twelve administrations into one, it has made it possible for the City to reduce administrative overhead, provide streamlined, cost-effective services and make sure residents received some direct benefits in the form of a cut to the property tax rate. Moreover, savings resulting from amalgamation have allowed the City to absorb significant costs associated with inflation and provincial downloading of services.

Amalgamation has also made it possible for City staff to form a more realistic long-range picture of current and anticipated operating and capital needs than was possible with 12 separate, competing local governments.

The picture emerging is clear: reducing expenditures and achieving administrative efficiencies alone has not met current needs, nor will it address future challenges. As a result, the City’s capital forecast estimates a $270 million funding gap by 2006. This gap continues and increases throughout the following five-year period. A careful examination of the City’s long-term capital program reveals that over half of the requirement is needed to simply take care of the assets we already have, and over 25 per cent is needed to take care of the requirements of growth. The remainder provides support for the City’s ongoing programs, like traffic control and safety and sports field development, and for some new initiatives like investing in more ambulances to improve response times and addressing new requirements arising from changes in provincial legislation, such as those arising from the events in Walkerton.

Economic growth in cities is critical to the success of the national economy. It creates significant tax revenue for both the federal and provincial governments but not, ironically, for the municipalities that drive the growth. Growth creates massive demands on services and infrastructure that cities alone must fund.

In 2001, a KPMG study found that, between 1998 and 2000, economic growth in the City generated $753 million in new tax revenue for the federal and provincial governments, with only an additional $77 million for the City itself.

A clear consensus has emerged among economic and policy experts that Canada’s cities lack the legislative and financial tools needed to fund the services and programs they must deliver. Indeed, while federal and provincial governments pay for programs in a number of ways — including income, payroll, sales, corporate, and fuel taxes — municipalities in Ontario are permitted to fund their services only through property taxes, development charges, and user fees. Moreover, while revenues from income and sales taxes are bolstered during periods of strong economic growth, revenue from property taxes is not.

The development of this Long-Range Financial Plan can help the City to meet its challenges directly and with foresight. Between now and 2011, the City of Ottawa will need to continue to find innovative ways to improve services and reduce costs and, at the same time, carefully examine and cultivate new sources of revenue. Without these new sources of additional revenue, and despite the City’s best efforts, the funding gap will only continue to grow.

Ottawa is not alone in this regard. The TD Economics report, A Choice Between Investing in Canada’s Cities or Disinvesting in Canada’s Future, graphically conveys the predicament faced by Canada’s municipalities:
Hit by the double whammy of weak revenue growth and downloading of services, it is hardly surprising that municipal governments have had to run up debt, defer infrastructure projects, draw down reserves, sell assets and cut services in order to stay afloat.

In the urban millennium, a nation’s cities must thrive globally if that nation is to compete economically. Cities are also expected to be centres of innovation and education, and they must provide the highest possible quality of life to residents.

To that end, the United States and Europe have been making large-scale investments in municipal infrastructure. In Europe, infrastructure funding comes from the European Union, national and local governments, and public-private partnerships. The 2002-2006 European Regional Development Fund (ERDF) makes up one-third of the entire European Union budget, and helps fund transportation infrastructure, environmental and water projects. The ERDF is just one of a number of funds available to support the strengthening of municipal infrastructure across the European Union.

The United States federal government is also making impressive investments in urban infrastructure. The Transportation Equity Act for the 21st Century of 1999 has earmarked $217 billion US for transportation infrastructure over six years. A number of other federal grant and loan programs provide stable, long-term funding for wastewater, drinking water, housing, and community development projects in American cities.

The investments made in cities in Europe and the United States are paying off. In January 2001, the 2nd Report on Economic and Social Cohesion to the European Commission concluded that reinvestment in cities was an effective means of mobilizing private capital and loans, and led to increased competitiveness and productivity of urban regions. The Role of Metro Areas in the US Economy notes that American cities’ ability to compete in the global marketplace is largely due to the benefits of renewed infrastructure. Indeed, unlike other parts of the American economy, metropolitan areas continued to grow during the recent recession.

Some provincial governments in Canada have begun to demonstrate an understanding of the importance to municipal governments of having more flexible financial and legislative mechanisms within their reach. The governments of British Columbia, Newfoundland and Labrador, Alberta, Manitoba, Nova Scotia and Quebec have all either given municipalities authority to raise new revenues or transferred to municipalities portions of sales, income and fuel taxes. In some cases, provincial governments have done both. Further, Alberta has given cities natural person powers, which allows Alberta’s cities greater flexibility to enter into legal agreements. Perhaps most promising is British Columbia’s proposed Community Charter, which will, if enacted, give municipalities clear authority to make decisions and raise new revenues without having to secure provincial approval.

As more and more experts agree that with no change in the current distribution of revenue and authority among federal, provincial and municipal levels of government, cities cannot sustain growth, it is also clear that the City of Ottawa must continue to find solutions in areas it controls.

The City of Ottawa must adopt a more sustainable approach to development and growth. The City cannot resolve 21st century issues with 19th century institutions and models of revenue generation. Property taxes can no longer fund the bulk of services that municipalities deliver, and development charges are not designed to recover growth costs in full. Unless stable, long-term funding is secured, and until the City is given appropriate authority and financial tools, severe limitations will exist on its ability to manage growth.

The City must now devise a new revenue policy that accommodates the changing needs of residents, institutes clear standards for program and service fees and rates, and secures an appropriate and reliable base of funding into the future.

**Recommendations and Options**
Where the capital program funding gap is concerned, the report presents several options for Council’s consideration.

1. Use Hydro Ottawa revenue generated from interest and dividends, using stable rate structures. Hydro Ottawa is a valuable asset to the City and should be utilized to maximize its value to both the City and taxpayers by returning the interest and dividends to help finance the capital program. Hydro Ottawa revenue could reduce the capital-funding gap by $242.6 million in the next ten years.

2. Reduce the impact on capital reserve funds by ensuring that development charges are increased to recover as much of development costs as possible. The City’s funding model assumes that exercising this option will reduce the impact on capital reserves by ten per cent of growth costs. The development charge option could reduce the capital funding gap by $119.7 million in the next ten years.

3. Ensure that the capital program receives a fair share of new assessment growth. Capital contributions received from the growth in assessment should help pay for growth-related costs, as well as recover a portion of growth costs that cannot be recovered from non-residential development charges. The fairer sharing of assessment growth revenue between operating and capital budgets could reduce the capital funding gap by $138.5 million in the next ten years.

Together, these three options would provide additional tax-supported funding totalling $131.8 million over the first five years of the ten-year planning period and $497.2 million over the full period.
Even with this revenue, however, a shortfall is evident over the long term. A new federal/provincial/municipal funding formula and revenue-sharing agreement is required for Ontario’s cities. **Without a new revenue-sharing agreement, it may not be possible to support the current growth forecast.** Support is required from upper levels of government to maintain growth and the quality of municipal services. The Governments of Ontario and Canada will see consequent reduction in economic growth and in their own revenues if growth is slowed or stopped. The City urgently requires a wider range of revenue-sharing options, rather than the regressive property tax it relies on now. To that end, the report also recommends Council:

4. Ask the Government of Ontario to take over full funding responsibility for mandated health and social services programs, as has been done in other provinces. Transferral of full funding responsibility for these programs to the province would reduce the City’s tax levy by $186.2 million and completely close the funding gap.

5. Continue to work with other Canadian municipalities in requesting the total tax base be shared more equitably among federal, provincial and municipal governments. For example, if the City received a full refund of its Goods and Services Tax payments, five cents of the gasoline tax within Ottawa, ten dollars for each registered vehicle in the City, and funds equal to one per cent of personal income tax revenues from residents, the total would be $100.1 million each year. (As a comparison, Calgary receives $83 million annually and Edmonton $68 million annually from the province of Alberta’s fuel tax.)

If new revenues are not forthcoming from the federal and provincial governments, a funding gap will remain. As such, unless other revenue sources become available—such as those outlined in options four and five—the capital program will have to be reduced. **Without additional revenue, the City will have to review its growth objectives and assess its ability to continue to provide services at levels enjoyed today.**

Lifecycle spending levels will need to be slowed to match funding capability, and new initiatives and programs restricted to match available funding. Growth spending will have to be reduced to lower future operating costs. If not, standards within new growth areas cannot be maintained at today’s levels, and a capital surtax or tax and rate increases may need to be considered.

The City of Ottawa has worked to build an enviable quality of life for the people who live and work here. It’s imperative we continue to do our part to manage growth by building on our successes with efficiencies and streamlining. This Long-Range Financial Plan: First Steps and those that will follow provide some clear options and potential tools that will help make sure we are doing as much as we can to compete in the global economy and continue to provide high quality and cost-effective services to residents.

But Ottawa, like all cities in Canada, won’t be able to reach its full potential without long-term stable funding from the federal and provincial governments. The federal and provincial governments receive dramatically greater revenues from growth than the City and bear few of the costs. Growth in cities pays dividends for these levels of governments, and the taxpayers who fund that growth should reap the full benefits of their investment.

The next steps for the City of Ottawa will include submission of the draft 2003 budget estimates, an asset management review for transportation, water and wastewater infrastructure, and a final version of the City’s Official Plan. A second phase of the long-range financial plan will be developed based on this information and the results of the City’s other growth plans (the human services plan, the arts and heritage plan, the economic plan, and the corporate strategic plan). This second report will provide a more detailed ten-year forecast that will be submitted to Council in late 2003, along with the 2004 draft budget estimates.
1. The Long-Range Financial Plan: First Steps

During the City of Ottawa’s 2002 budget process, a funding gap in the City’s capital program was identified. More detailed study was undertaken and this funding gap was forecast to be $270 million by 2006, or approximately $100 million each year from 2004 on. As a result, Council directed staff to prepare a long-range financial plan to outline the City’s operating and capital needs, and to recommend strategies to address the funding gap.

In response, this long-range financial plan examines operating and capital needs over a period of ten years (2002-2011), sets out assumptions on which these needs are based, presents existing funding sources, outlines potential new funding sources (both those under Council’s control and those which may require decisions of other parties), and recommends actions by which the City can secure a solid financial future.

The long-range financial plan sets out a short-term capital forecast (2002-2006), and a long-term capital forecast (2007-2011). The short-term forecast provides significant detail on projects both anticipated and now underway. The long-term forecast offers reasonable spending estimates by grouping related projects together in spending envelopes. This two-part method has been used because planned projects may be affected over time by many variables, including economic fluctuations, changing growth rates, amendments to legislation and regulations, and further provincial downloading.

Although, this long-range financial plan constitutes a comprehensive examination of the City’s capital and operating needs, additional work remains. Next steps will include submission of the draft 2003 budget estimates, an asset management review for transportation, water and wastewater infrastructure, and a final version of the City’s Official Plan. A second phase of the long-range financial plan will be developed based on this information and the results of the City’s other growth plans (the human services plan, the arts and heritage plan, the economic plan, and the corporate strategic plan). This second report will provide a more detailed ten-year forecast that will be submitted to Council in late 2003, along with the 2004 draft budget estimates.

2. The Picture is Becoming Clearer: Ottawa is Not Alone

Ottawa is one of the most desirable cities in Canada in which to live. Indeed, over the past 20 years, the City has seen its population grow by a staggering 41.6 per cent. These people, in turn, have propelled significant economic development in the City, particularly in the past five years.

Population growth and economic development, however, have associated costs. As such, the City faces tremendous challenges: how will it continue to grow and thrive, sustain its exemplary quality of life, maintain its physical infrastructure, and be able to address unforeseen needs?

City Services include:

- Transit
- Libraries
- Paratransit
- Roads and sidewalks
- Clean drinking water;
- Wastewater and storm-water removal and treatment;
- Fire protection;
- Police services;
- Garbage removal and recycling;
- Public health;
- Social housing;
- Homes for the aged;
- Recreation and parks;
- Child care;
- Administration of Ontario Works
- Ambulances; and
- Planning, licensing and by-laws.

Amalgamation has placed the City in a stronger position to meet these challenges. Indeed, amalgamation has enabled the City to provide many of its services more efficiently and effectively than ever before. Moreover, savings resulting from amalgamation have allowed the City to absorb significant costs associated with inflation and provincial downloading of services. Equally important, amalgamation affords City staff the opportunity to form a more realistic long-range picture of current and anticipated operating and capital needs than was possible with 12 separate, competing local governments.

The advantages of amalgamation alone, however, have proven insufficient to allow the City to overcome this challenge. Ottawa is not alone in this regard. Other cities in Canada that try to accommodate rapid growth with aging infrastructure share the predicament. Edmonton, for instance, recently revealed that its ten-year capital funding gap is expected to total approximately $3.2 billion, with 58 per cent of that amount ($1.8 billion) directly attributable to population and economic growth. Meanwhile other cities, Toronto among them, are just beginning to assess their long-term needs. In all likelihood, they too will be facing significant funding gaps. Indeed, stories such as the one found in the September 24, 2002 edition of the Calgary Herald entitled “Budget Fears Revealed” appear in the media with increasingly regularity. Over the past decade, cities in Canada have been asked to do more with less.

Over the past decade, cities in Canada have been asked to do more with less.
Canada’s cities are unquestionably the economic growth engines of the nation. More than 60 per cent of Canada’s total employment growth over the last four years has occurred in just ten urban regions. Population and economic growth in urban areas are critical to the national economy. They create significant tax revenue for both the federal and provincial governments but not, ironically, for the municipalities that drive the growth. Growth creates massive demands on services and infrastructure that cities alone must fund.

A clear consensus has emerged among economic and policy experts that Canada’s cities lack the legislative and financial tools needed to generate enough revenue to fund the services and programs they must deliver. Indeed, while federal and provincial governments raise revenue to pay for programs in a number of ways—including personal and corporate income taxes, payroll taxes, sales taxes, corporate taxes, and fuel taxes—municipalities in Ontario are permitted to raise revenue only through property taxes, development charges, and user fees. Moreover, while revenues from income and sales taxes are bolstered during periods of strong economic growth, revenue from property taxes is not.

The City of Ottawa receives an estimated seven cents of every new tax dollar generated here; federal and provincial governments receive the balance.

The figures that underlie the dilemma faced by the City are stark. In 2001, a KPMG study found that, between 1998 and 2000, economic growth in the City generated $753 million in additional tax revenue for the federal and provincial governments yet only $77 million additional revenue for the City itself. Put another way, today, the City receives an estimated seven cents of every new tax dollar generated in Ottawa; the federal and provincial governments receive the balance. Between 1995 and 2001, while federal government revenue across Canada climbed 38 per cent and provincial government revenue rose by 30 per cent, municipal revenue increased by only 14 per cent. For municipalities, this figure constituted a per capita decrease.

Over the past 18 months, several studies have been undertaken to examine the role played by Canada’s cities, the challenges they face, and the options available to them. These studies include:

- The Role of Metro Areas in the US Economy, DRI-WEFA, June 2002;
- FCM Annual Meeting, May 2002;
- A Choice Between Investing in Canada’s Cities or Disinvesting in Canada’s Future, TD Economics, April 2002;
- Municipal Finance and the Pattern of Urban Growth, CD Howe Institute, February 2002;
- Communities in an Urban Century, Symposium Report, FCM, January 2002;
- Early Warning: Will Canadian Cities Compete?, Federation of Canadian Municipalities (FCM), May 2001; and

Program expenses and physical infrastructure costs that benefit the national economy are borne primarily by municipalities.

In recognizing that most of Canada’s economic activity takes place in urban areas, these studies agree that Canada’s cities must have the programs and physical infrastructure in place to sustain the population growth and development that comes from increased economic activity. Moreover, social programs and physical infrastructure are critical to strengthening overall national competitiveness. At this point in our history, the costs associated with these programs and with infrastructure development are borne primarily by municipalities. Increasingly, however, it is becoming clear that municipalities lack the stable funding, necessary authority and financial flexibility to fund these requirements alone.

In order to sustain growth and deal with the effects of federal and provincial downloading, municipalities throughout Canada have employed several short-term financial strategies to address the needs of their citizens. These strategies have included drastically reduced funding of infrastructure maintenance, depletion of reserve funds, delayed construction of required infrastructure, use of one-time revenues, operating costs charged to capital, and conservatively estimated operating costs. Indeed, the TD Economics report graphically conveys the predicament faced by Canada’s municipalities:

Hit by the double whammy of weak revenue growth and downloading of services, it is hardly surprising that municipal governments have had to run up debt, defer infrastructure projects, draw down reserves, sell assets and cut services in order to stay afloat.
3. An Overview of Ottawa’s Situation

As more and more experts agree that with no change in the current distribution of revenue and authority among federal, provincial and municipal levels of government, cities cannot sustain growth, it is also clear that the City of Ottawa must continue to find solutions in areas it controls.

Recognizing the challenges faced by taxpayers, the 12 former municipalities that became the new City of Ottawa had frozen or reduced property taxes and rates for a number of years prior to 2001. Faced with revenues growing at a slower rate than the services they fund, municipalities in the Ottawa region continuously improved their methods of providing service while reducing expenditures. Following amalgamation, in 2001, the tax rate was cut by ten per cent; this rate cut was maintained in 2002. The freezes and cut in rates meant absorbing both the cost of inflation and the cost of downloaded provincial responsibilities; the costs of downloading alone have added over $50 million per year to the City’s budget.

As a result of the property tax rate freeze, when adjusted for inflation, the average urban resident now pays 20.5 per cent less in property taxes than in 1993, and the average rural resident pays 21.9 per cent less. (see Chart below).

During this period, Ottawa has been one of the fastest growing cities in Canada. To examine potential solutions and plan for long-term growth, therefore, Council adopted a realistic forecast that clearly recognizes current growth rates and increases physical infrastructure requirements. In the past, growth had led to traditional suburban development that was matched by increasing demand for lower density, largely car-based infrastructure. Indeed, this type of infrastructure demand has been responsible for a significant portion of the present capital infrastructure gap. This demand is forecast to increase as the long-range financial plan moves toward 2011.

The City must adopt a more sustainable approach to development and growth.

As a result, the City must recognize that it cannot afford to continue to subsidize development and growth as it has done in the past. The City must reconsider where development takes place, as well as its true cost. In turn, ways must be found to recoup a portion of the City’s funding shortfall by changing the way in which the City develops. It should be noted here that a substantial portion of the costs of growth in the City has been subsidized by property taxpayers.

Lifecycle maintenance of existing physical infrastructure—roads, bridges, pipes, and buildings—also presents a unique challenge. Historically, resources sufficient to maintain physical infrastructure have not been included in forecasts and planning. This situation is, in fact, common to municipalities throughout the country. Again, the recent report by TD Economics provides the underlying figures:

The Association of Consulting Engineers of Canada (ACEC) estimated that the total municipal infrastructure shortfall in Canada is at least $44 billion ... TD Economics estimates that the total infrastructure shortfall is growing by about $2 billion per year.

Although all available tools are being examined to determine the ideal way to address the City’s capital and operating needs, every city in Canada requires more flexibility to generate revenue. Further, stable funding arrangements with federal and provincial governments are critical if cities are to enjoy long-term financial health and economic growth.

The City is meeting its challenges directly and with foresight. While continuing to improve ways to provide service while reducing expenditures, finding greater efficiencies in service delivery alone will not be enough to close the funding gap. The challenge for the City between now and 2011 will be to continue to find innovative ways to improve services and reduce costs and, at the same time, carefully examine and cultivate new sources of revenue. Without these new sources of additional revenue, and despite the City’s best efforts, the funding gap will only continue to grow.
4 Ottawa is Part of a Bigger Picture

Cities have always been centres of economic activity and growth. With the advent of free trade, cities have become key drivers of national economies, and investments in urban infrastructure provide significant benefits to communities beyond urban boundaries. Indeed, The Role of Metro Areas in the US Economy notes that the gross product of the five largest metropolitan areas in the United States ($1.68 trillion) outperformed every national economy in the world except for the United States ($10.21 trillion), Japan ($4.15 trillion) and Germany ($1.85 trillion). Within the United States, the gross product of the ten largest American metropolitan areas exceeded the output of the 31 smallest states.

This renewed vitality of the world’s cities is exciting for those who live there, and rewarding for all those who benefit from their productivity. A general consensus is emerging of which factors allow cities to compete successfully in the global marketplace while being desirable places in which to live and work. Seizing the initiative, national governments in the United States and Europe have made major investments to ensure their cities continue to thrive. Canada’s federal and provincial governments have not yet recognized that they must make similar investments if Canadian cities are to compete and prosper.

4.1 19th Century Solutions Can’t Solve 21st Century Problems

In 1867, Canada was largely a rural country with a resource-based economy. Since Confederation, the Canadian economy has diversified significantly. Moreover, Canada is now an overwhelmingly urban nation. Indeed, nearly 80 per cent of Canadians live in urban areas, with 45 per cent of them living in the country’s seven largest cities (Toronto, Montreal, Vancouver, Ottawa-Gatineau, Calgary, Edmonton and Winnipeg).

Although Canada has undergone radical change over the course of the last 135 years, the statutory mechanisms regulating affairs between federal and provincial governments and their municipal counterparts have not. Indeed, in Canada’s founding statute, the Constitution Act of 1867, provinces were given complete control over municipal institutions. In turn, the role, function and structure of these municipal institutions were set out some 20 years prior to Confederation. In 1867—135 years ago—this seemed an appropriate arrangement. Today, it is no longer viable.

The current legal framework within which municipalities operate limits their ability to manage and regulate the programs and services they are responsible for delivering. Essentially, municipalities in Canada have only three ways to raise revenue: property taxes, development charges and user fees. Due to their limited flexibility, these ways are insufficient to meet the City’s need for additional revenue.

This is not the case in the United States and Europe, where considerable effort has been made to give cities the necessary supports to become and remain successful. In the United States, local governments are granted powers by their state.

Home rule charters, however, also govern larger municipalities in the United States, and many of the smaller ones. These charters allow cities to determine themselves how they should be organized, what services they should deliver, and to what extent local matters should be regulated—all with no interference from the state. These charters also give cities authority to determine revenue sources, set tax rates, levy new taxes, borrow funds and use any number of other financial instruments at their disposal. As a result, American cities can determine which services they will provide, and raise the necessary revenues (see Table 1).

Table 1 Municipal Fiscal Authority: Canada and the U.S.A.

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<td>License fees</td>
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<td>Income tax: individual and corporate</td>
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<td>Tax incentives</td>
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<td>Grants to corporations</td>
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<td>Borrow money</td>
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* Indicates rare instances of this type of authority
Source: Federation of Canadian Municipalities

In Europe, services offered by local governments vary greatly, as does the authority of these governments. Throughout Europe, however, a strong understanding has developed of the important role cities play as centres of economic growth and employment. This understanding is expressed in the principle of subsidiarity, which is embedded in the European Union’s Treaty of Maastricht. This principle formally recognizes that higher levels of government should exercise authority only when there are obvious and compelling reasons to do so. Subsidiarity also decrees that the level of government that has authority should have the resources needed to meet its responsibilities. The European Union, for instance, offers access to funding that allows local governments to leverage additional financing from their host countries for projects that support sustainable development in the broadest sense—environmental, social and economic.
The practical effect of this difference in defining authority and access to revenue is noteworthy. The Federation of Canadian Municipalities estimates that, in 1997, Canadian municipalities spent $785 US per capita, while American cities spent $1,652 US and European cities averaged $2,100 US.

Some provincial governments in Canada have begun to demonstrate an understanding of the importance to municipal governments of having more flexible financial and legislative mechanisms within their reach. The governments of British Columbia, Newfoundland and Labrador, Alberta, Manitoba, Nova Scotia and Quebec have all either given municipalities authority to raise new revenues or transferred to municipalities portions of sales, income and fuel taxes. In some cases, provincial governments have done both. Further, Alberta has given cities natural person powers, which allows Alberta’s cities greater flexibility to enter into legal agreements. Perhaps most promising is British Columbia’s proposed Community Charter, which will, if enacted, give municipalities clear authority to make decisions and raise new revenues without having to secure provincial approval.

Although progress underway throughout the country is welcome, the fundamental constitutional framework governing municipalities has not changed. The provinces continue to retain control of the legislative and taxing powers of local governments, and provincial governments can restrict or change any previously granted powers at any time. Alberta, for instance, has unilaterally reduced Calgary and Edmonton’s share of the fuel tax from 5 cents to 1.2 cents, effective March 2003. The future progress and stability of Canada’s cities is threatened by an absence of authority over the services they are responsible for delivering, as well as a lack of stable funding mechanisms to support these services.

4.2 Infrastructure Investments Are Critical to Canada’s Economic Success

According to United Nations Secretary-General Kofi Annan, the world has entered the “urban millennium.” In the urban millennium, a nation’s cities must thrive globally if that nation is to compete economically. Cities are also expected to be centres of innovation and education, and they must provide the highest possible quality of life to residents.

To that end, the United States and Europe have been making large-scale investments in municipal infrastructure. In Europe, infrastructure funding comes from the European Union, national and local governments, and public-private partnerships. At $175 billion US, the 2002-2006 European Regional Development Fund (ERDF) makes up one-third of the entire European Union budget. ERDF is available to any city or region that can demonstrate both a need and the availability of matching funds within the host country. In recognition of the importance of transportation infrastructure, over one-half of ERDF funds are targeted for these projects. Some one-third is targeted for environmental and water projects. ERDF is just one of a number of funds available to support the strengthening of municipal infrastructure. Other funds (listed in Appendix 2.1) provide funding for a wide variety of infrastructure and redevelopment projects.

The United States federal government is also making impressive investments in urban infrastructure. The Transportation Equity Act for the 21st Century of 1999 has earmarked $217 billion US for transportation infrastructure over six years. Of this total, over $100 billion US has been made available for public transportation. Further, the act enshrines a transit benefit tax to help level the playing field between parking benefits and transit/carpooling...
benefits. The act also allows cities to leverage federal resources to encourage private-sector involvement, including direct credit assistance, such as loans, loan guarantees and lines of credit from the Department of Transport for up to one-third of project costs. Finally, the act permits toll revenue credits, where revenues from roads and public bridges count as matching funds for federal grants for other modes of transportation, such as transit. A number of other federal grant and loan programs (listed in Appendix 2.2) provide stable, long-term funding for wastewater, drinking water, housing, and community development projects in American cities.

The approach undertaken in Europe and the United States is paying off. In January 2001, the 2nd Report on Economic and Social Cohesion to the European Commission concluded that reinvestment in cities was an effective means of mobilizing private capital and loans, and led to increased competitiveness and productivity of urban regions. The Role of Metro Areas in the US Economy notes that American cities’ ability to compete in the global marketplace is largely due to the benefits of renewed infrastructure. Indeed, unlike other parts of the American economy, metropolitan areas continued to grow during the recent recession.

In Europe, national contributions to public transportation are also substantial. European G8 member nations fund between 15 and 30 per cent of operating costs and between 30 and 100 per cent of capital expenditures. In the United States, the Transportation Equity Act for the 21st Century is the largest infrastructure investment program in that country. Under the act, combined state and federal funds cover 25 per cent of operating costs and 54 per cent of capital expenditures for public transit. Moreover, the United States and European countries employ a range of innovative financing strategies to fund transportation infrastructure. These strategies include direct credit, toll revenue credits, joint development of transit assets, transport contribution taxes and toll ring roads.

American and European governments have recognized the critical role transportation infrastructure plays in serving as the backbone of every large city’s economy. Transportation infrastructure is a considerable expense for government, but it pays off in both ease of commercial activity and development of a high quality of life that attracts businesses and residents.

In contrast, investment in infrastructure by Canada’s federal and provincial governments has been declining. Further, transfer payments and grants that remain tend to be conditional, shorter term and project-based. Moreover, the conditional nature of these programs directs funding to eligible projects, which are not necessarily the most urgent or important priorities of local governments.

The Association of Municipalities of Ontario summarized the situation facing Ontario’s municipalities in its 2000 Municipal Councillors’ Guide:

What a difference a decade makes! The Ontario Grant Reforms Committee of the late 1970s had identified almost 90 different grant programs … The number of different grant programs had reached 100 by the end of the late 1980s. Today, apart from the possibility of temporary transitional funding, and occasional special financial assistance, municipalities receive essentially one annual grant, the Community Reinvestment Fund.

In the case of transportation infrastructure, Canada is the only G8 country without a national urban transit investment fund. In fact, Alberta, British Columbia and Quebec are the only governments in Canada that provide ongoing support for public transit, although other provinces like Ontario have begun new grant programs. The Canadian Urban Transit Association estimates that a $9.2 billion capital investment over five years is required for public transportation. The Federation of Canadian Municipalities estimates the United States invests in urban transportation at more than 100 times the rate of the Canadian government.

The figures are equally revealing when transfers to municipal governments are examined. Combined transfers from both state and federal governments in the United States accounts for 27 per cent of all municipal revenues; in Europe, these transfers total 31 per cent; in Canada, combined transfers from federal and provincial governments accounts for 18.7 per cent of municipal revenues. In the case of Ontario, funding is almost exclusively related to income maintenance programs, which are cost-shared between the province and the property tax base.

Some signs have appeared recently to indicate that governments in Canada are, at a minimum, contemplating the funding challenges faced by municipalities. The Prime Minister’s Task Force on Urban Issues recognized in its April 2002 Interim Report that Canada’s cities require, “a new approach that includes stable federal funding for urban infrastructure programs and funding for projects that clearly exceed the fiscal capabilities of municipal governments.”

Constructive action must now follow these words. For until municipalities are granted both the authority and the tools they need to secure stable, long-term funding, they will be unable to manage the demands of urban growth.

4.3 Shifting the Cost Burden

In 1998, the Government of Ontario instituted Local Services Realignment (LSR), otherwise known as downloading. Originally projected to be revenue neutral, LSR saw municipalities assume greater responsibility for a number of key services, including public transit, police, property assessment services, septic system inspection, social housing, and land ambulances.
In practice, LSR has not been revenue neutral. Instead, it has imposed a heavy financial burden on municipal governments throughout the province. For instance, as a result of LSR, the City now must spend an estimated $50 million more each and every year. This cost burden is increasing and is expected to continue to increase over the next ten years, as growing demands are made on services and as more services are downloaded.

**Ontario is the only Canadian province that requires municipalities to fund significant health and social services programs on a property tax base.**

In addition, Ontario is the only Canadian province that requires municipalities to fund significant health and social services programs on a property tax base. While Ontario controls and mandates a great number of social and health programs, it continues to require that costs of these programs be shared by municipalities and funded through property taxes. These programs include public health, employment and financial assistance, childcare and social housing. Meanwhile, other provinces have abandoned this requirement, allowing the property tax base to support those programs for which municipalities have direct responsibility.

Cost-shared health and social services add significant pressures to the property tax base. In 2002, $186.2 million was required from the City’s property tax base to pay for health and social services programs downloaded from the provincial government.

In 2002, $186.2 million was required from the City’s property tax base to pay for health and social services programs downloaded from the provincial government.

Other than capital grants, operating transfers from the Government of Ontario have declined from $493 million in 1995 to $272 million in 2002 (see Chart 3). This decline has had a significant impact on municipal revenue. As well, some federal grants designed to help programs municipalities deliver end up being used by provincial governments on unrelated expenditures. When expressed as a percentage of the City’s gross revenue, these transfers have fallen from 31 to 15 per cent. The rate of decline has been a precipitous 9.1 per cent per year.

### Chart 3: Operating Transfers from Other Governments (million $)

<table>
<thead>
<tr>
<th>Year</th>
<th>Transfer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>$493</td>
</tr>
<tr>
<td>1996</td>
<td>$391</td>
</tr>
<tr>
<td>1997</td>
<td>$371</td>
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<td>1999</td>
<td>$336</td>
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<tr>
<td>2000</td>
<td>$286</td>
</tr>
<tr>
<td>2001</td>
<td>$279</td>
</tr>
<tr>
<td>2002</td>
<td>$272</td>
</tr>
</tbody>
</table>

*Source: DBRS & City of Ottawa Budget*

### 5. The City’s Capital Funding Requirement

#### 5.1 Capital Expenditure Categories

Capital expenditures are made to purchase, develop and renovate assets that support City services and whose lives extend beyond one year. Anticipated spending on these services forms the City’s capital funding requirement.

Projects related to the treatment and delivery of drinking water are funded through the Water Fund. Projects related to the collection and treatment of sanitary and storm sewage are funded through the Sewer Fund. The City’s water and sewer utilities charge user fees intended to cover the full costs of these utilities. All other projects are funded through property taxes. Currently, taxes are collected through the city-wide levy and urban and rural transit levies. Other revenues, such as development charges and grants, reduce the City’s funding requirement from the aforementioned revenue sources.

Capital expenditures are grouped into four categories: lifecycle maintenance (to care for existing assets); and growth (to support new residents and businesses), which form the bulk of the requirement, and ongoing programs (to address ongoing community priorities) and new initiatives (to fund new programs and assets that are not growth related).

#### 5.1.1 Ongoing Programs

Ongoing programs are determined by community needs not characterized as lifecycle or growth related. Generally, these programs—like community-related facilities, affordable housing, new street or park pathway lighting, sports field development, and park and intersection improvements—consist of annual allotments that gradually increase the level of service throughout the City and are an important part of the City’s day-to-day service delivery to residents. Also included in this category is planning work—such as the Official Plan and master plans—performed on a cyclical basis. These programs are generally paid through taxes and utility rates.
5.1.2 New Initiatives

New initiatives are large one-time projects that provide a new or improved level of service. Examples could include new transit initiatives, a new library branch, and expansion of the ambulance fleet that are driven by improving service to existing residents rather than by growth. Generally, these initiatives are funded through taxes and utility rates.

5.1.3 Lifecycle Maintenance

The City’s physical assets have a total estimated value of some $20 billion. These assets include roads and sewer infrastructure, sidewalks, water, fleet equipment, information technology, parks and buildings. To protect its investment and ensure the economical, efficient and effective performance of these assets, the City must perform appropriate maintenance and repair, along with the timely replacement of key components. This long-range financial plan identifies the estimated level of expenditure needed to address ongoing needs of these physical assets, as well as the impact of deferred maintenance activity. Generally, lifecycle maintenance is funded from the property tax base or the water and sewer surcharge rate base.

Over the past number of years, local municipalities have been unable to make all investments necessary to maintain their infrastructure. Most local governments across Canada were confronted by this situation; often, few options were available to municipal councils and staff. Although past decisions to underfund asset maintenance and repair of assets may have been made out of financial necessity, these decisions have resulted in a significant list of deferred maintenance work.

Accumulated deferred maintenance has a cost. Major physical infrastructure failure can lead to sizeable downtime, increased costs to local business, and impacts the City’s ability to serve residents and attract industry. Deferred maintenance also carries associated health and public safety risks, higher utility consumption and other operating costs, and a higher number of unforeseen repairs and replacement work. It may also lead to the need to close a facility, as happened with the Plant Bath, thereby reducing service levels.

Significant capital expenditures are now required to ensure the City’s property and other assets are maintained at acceptable levels. Outlined below are each of the City’s major functional areas responsible for lifecycle maintenance.

Properties and Facilities

Real Property Asset Management is responsible for all of the City’s 1024 structures, furniture and related equipment, as well as other real property. Due to the size and complexity of the City’s asset mix, lifecycle expenditure requirements are best described by average spending level based on overall facility value.

A number of guidelines for facility renewal funding have been established by professional organizations. The American Public Works Association has published guidelines allocating a minimum two to four per cent of current facility replacement value to provide for facilities renewal. The Society for College and University Planning, National Association of College and University Business Officers, and Association of Physical Plant Administrators of Universities and Colleges recommend 1.5 to 2.5 per cent of replacement value to keep facilities in proper condition for their present use.

City staff recommend calculating the building asset renewal program on the basis of a conservative 1.5 per cent of the replacement value of renewable building infrastructure, which is approximately 80 per cent of the total replacement value of the City’s building portfolio. City staff estimates an accumulated deferred maintenance amount of $31 million for the entire building portfolio, and, if funded at the forecast level, the accumulated deferred maintenance obligation will be eliminated by 2011 (see Appendix 4.1). Other options include reducing the number of facilities through disposal. The Corporate Accommodation Master Plan currently underway will investigate the possibilities of this approach for the City’s administrative space requirements.

Fleet

The City’s Fleet branch is responsible for all City vehicles, including fire vehicles, ambulances and buses. As City vehicles age, maintenance costs increase while resale value and reliability decrease. Consequently, Fleet branch must determine an optimum economic replacement point for each vehicle where vehicle replacement becomes a superior option to repair or refurbishment. A variety of factors determines a vehicle’s economic replacement point, including maintenance costs, depreciation, downtime, operational impacts, obsolescence, support costs, residual value, reliability and subsidization.

Standard life expectancies vary according to vehicle type and use. For example, the daily routine of waste collection trucks results in shorter lives for these trucks compared with trucks equipped with dump bodies or salt spreaders, which have a more limited use. Each City vehicle has an assigned life expectancy. (These vehicle life expectancies are listed in Table 2.)

<table>
<thead>
<tr>
<th>Component</th>
<th>Life Expectancy (Years)</th>
<th>Current Average Retirement Age (Years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transit Buses</td>
<td>16</td>
<td>26.6</td>
</tr>
<tr>
<td>Fire Apparatus</td>
<td>15</td>
<td>23.3</td>
</tr>
<tr>
<td>Ambulances</td>
<td>4.5</td>
<td>4.5</td>
</tr>
<tr>
<td>Heavy Fleet</td>
<td>10</td>
<td>14.5</td>
</tr>
<tr>
<td>Light Fleet</td>
<td>7</td>
<td>12.4</td>
</tr>
</tbody>
</table>

Table 2
Lifecycles of City Vehicles
As can be seen, many City vehicles exceed their expected lifecycle age. The City's fleet vehicle replacement capital plan was developed to identify long-term, capital funding requirements to replace City vehicles. This plan was prepared by phasing these spending requirements into the recommended spending plans between 2007 and 2011 to achieve economic life standards by 2011 (See Appendix 4.2).

A recent review of City fleet maintenance costs for vehicles that exceed their scheduled lives showed maintenance costs 23 to 37 per cent above those costs for vehicles within their scheduled lives. Assuming maintenance costs of 30 per cent for over-age vehicles, and an annual fleet maintenance budget of $12 million, the City incurs additional annual maintenance costs of $1.3 million for over-age vehicles. For the City's transit fleet, maintenance and refurbishing costs on over-age vehicles is $2 million each year. These additional costs must be added to fleet budgets until a steady state is reached in 2011.

Information Technology
Information Technology (IT) provides key work tools and solutions to all City departments, and is recognized as an essential cost-saving business tool. As such, provision of reliable and effective technology infrastructure and support for corporate systems is vital to City business operations.

Information Technology assets include physical hardware, intellectual property (software), and information (data stored electronically). A number of research organizations provide industry best practices and benchmarks with respect to depreciation and replacement. Combined with analysis and research provided by IT managers, based on professional experience, historical trends and municipal practices, these benchmarks offer a solid lifecycle maintenance schedule.

Computer hardware and associated infrastructure is replaced either when it no longer functions to acceptable performance standards or when new versions of software will not function.

Computer software is also subject to regular maintenance (installation of patches or fixes), upgrades (new releases), and eventual replacement. Software must be replaced either when it is no longer supported by the vendor or when software no longer functions on available hardware.

IT infrastructure and software replacement is dependent on asset type and technological development. For example, desktop computers are typically replaced on a three-to-four-year cycle. Network servers, on the other hand, typically have a longer useful life span, due to their function and assuming proper preventive maintenance has been performed. Industry best practices suggest a six-to-eight-year replacement cycle. (See Appendix 4.3)

Submissions to the City's 2002-2006 IT capital budget reflect current standards and qualitative measures. New standards are proposed to be phased in starting in 2007, and will be fully implemented by 2011.

Transportation, Waste Diversion, Water and Sewer Infrastructure
Transportation, Utilities and Public Works is responsible for lifecycle maintenance of all of the City's physical infrastructure, including transportation systems, pipes, treatment plants, and landfill sites (See Appendix 4.4).

The American Public Works Association, American Water Works Association, Transportation Association of Canada, and Federation of Canadian Municipalities—to name a few—have all undertaken a number of studies to develop effective rehabilitation and replacement strategies for physical infrastructure. As a result of these studies, it is apparent that the City needs to use a rehabilitation and replacement methodology with enough sophistication to address specific complexities in infrastructure sustainability. This methodology will have to look at changes in material types, construction techniques, long-term service level requirements, environmental considerations, and the special requirements of buried infrastructure. Further, construction of infrastructure has been undertaken during periods of sporadic growth, resulting in age-wave effects on infrastructure instead of demands for consistent rehabilitation.

Sidewalks, Transit, Roads and Bridges
The City's transportation network is comprised of 1,415 kilometres of sidewalks, 60 kilometres of transitway, 5,200 centreline kilometres of roads, and 95 bridges—the majority of which is in good condition. Preventative maintenance needs, however, are substantially underfunded, to the point that current expenditure levels are approximately two-thirds of what is required. Accordingly, the City's deferred maintenance inventory is growing quickly. An inability to perform rehabilitative work in a timely fashion also leads to a substantial increase in funding requirements to undertake more expensive reconstruction. Budget forecasts identify future reductions to this funding gap. It is estimated that appropriate lifecycle funding levels will be achieved in 2008 and then maintained for the remainder of the forecast period.

Water, Waste Water and Storm Drainage
The City operates and maintains 2,550 kilometres of water mains, providing potable water from two treatment plants, which are supported by 13 storage facilities and 14 pumping stations.

The City has 2,050 kilometres of sanitary and combined sewers with 57 lift stations carrying flows to the Robert O. Pickard Environmental Centre for primary and secondary treatment. Storm drainage is provided by a sewer network totalling 1,825 kilometres in length, with 101 stormwater detention facilities, as well as ditches—mostly roadside—totalling 8,000 kilometres.
Generally, water and sewer networks enjoy a long lifecycle. These networks are composed of a variety of materials to different standards. With several notable exceptions, the City’s water and sewer networks are in good operating condition. Hydraulic needs are, however, much greater. Addressing these deficiencies drives much of the prioritization of rehabilitation/reconstruction needs. These needs are addressed through sewer separation, capacity improvements, and work to address basement flooding issues for sewers, and capacity and service issues for water mains.

The City’s water and sewer needs are comparable to those in other North American cities; however, current capital spending levels are not adequate—again resulting in a growing gap between needs and rehabilitation activities. Although major initiatives are being undertaken to forecast funding needs, straightforward depreciation forecasts indicate essential network funding levels will be reached by 2008 and then maintained for the remainder of the forecast period.

5.1.4 Growth

New residents and businesses require either new or expanded municipal infrastructure to service their needs. For the purposes of this long-range financial plan, this kind of infrastructure is known as growth infrastructure. Although driven by growth, these infrastructure projects often benefit existing residents. For example, if the City standard is one ice rink for a specified number of people, when the population grows, the City will require a proportionate number of new ice rinks. Since all residents profit from these projects, they are funded both by development charges and by property taxes and utility rates.

**Ottawa 20/20 and Charting a Course**

Ottawa 20/20 is the City’s initiative to manage the growth it will experience over the next two decades. This initiative began in June 2001 with the Ottawa 20/20 Smart Growth Summit, where citizens heard from national and international experts and each other in an effort to become familiar with sustainable development principles. Ottawa 20/20 strives to protect and build on a quality of life that the City’s residents value.

Five growth management plans are now being prepared: the City’s Official Plan, a human services plan, an arts and heritage plan, an economic plan, and a corporate strategic plan. Findings of these plans will be reflected in future capital budgets and form the basis of the next steps for the City’s long-range financial plan.

**The Official Plan**

A preliminary draft Official Plan was tabled with the City’s planning and development committee on June 27, 2002. Tabling the plan initiated a public consultation process that will continue well into the autumn of this year, culminating with a final draft Official Plan in January 2003. Following a second public consultation period, Council will adopt the Official Plan in the spring of 2003.

The Official Plan will be supported by several other plans, including a transportation master plan, an environmental strategy, and water, wastewater, and stormwater master plans, which, where possible, will be developed concurrently with the Official Plan.

Although the preliminary draft Official Plan covers a spectrum of growth management goals for the next twenty years, a number of these goals, and related policies, will have a direct bearing on the City’s attempt to lessen capital budget pressures. These goals include promoting walking, cycling and transit as viable alternatives to automobiles, supporting development within existing urban and village boundaries, and increasing development densities near transitway stations, along arterial roads, and on main streets. If the goals of these plans are achieved, long-term capital budget pressures on the City can be reduced.

If the goals of the City’s growth plans are achieved, capital budget pressures can be reduced by 2011.

**Growth Forecast**

To plan for growth, the City must know how quickly growth will occur. On October 10, 2001, Council adopted a growth forecast that will form the basis of the Official Plan. This forecast was developed based on recent development activity and compared with the 2001 census for consistency. This growth forecast has been used for the long-range financial plan and is reflected in Chart 4 below. The forecast shows a 26 per cent increase in population from 2001 to 2011, from 800,000 to 1,012,000. As noted previously, employment is forecast to grow from 475,000 jobs to 655,000 over the same period, an increase of 38 per cent.

The growth forecast helps determine the demand for physical infrastructure. Stormwater management ponds are built prior to construction of the first houses in a new subdivision. Water treatment plants must be expanded in advance of increased demand. Parks and fire stations are built once residents are in place. Transportation works, including new and expanded roads and transit systems, are determined by the increased travel needs of additional residents.
The present population forecast has the City adding some 400,000 people in the next 20 years. This degree of growth, if accommodated using a traditional suburban development pattern, would be matched by increasing demands for automobile-based infrastructure. This type of infrastructure demand has already generated a significant portion of the capital infrastructure deficit experienced by the City.

Funding transportation infrastructure is one of the major challenges of growth. Currently, the City funds transportation initiatives using both the city-wide levy for roads projects and the transit levy for transit initiatives. This funding practice has been carried over from the former Region. The transit levy now provides funding for new and replacement buses, transit maintenance facilities, transitway rehabilitation and expansion and other capital projects identified with the transit operation. Transit capital funding is collected from within the urban transit area only. In the future, expansion of road and transit networks should be funded from the same tax base.

Transportation solutions should be considered on a city-wide basis recognizing that expansion of both the transit and road networks may be required to form the solution. Extension of the transitway or alternate transit services should be seen as a transportation solution in the same manner as road construction and should be funded from the same tax base.

The urban or rural transit levy should be earmarked for operating and capital requirements of the transit service (such as buses, garages and other services that directly support the operation) within either the urban or rural areas. This approach has already been adopted in the rural service strategy.

The City’s capital infrastructure deficit can be reduced by changing the way the City develops. One alternative is investing in high quality transit, which in turn reduces the need to build more arterial roads and expressways. This alternative also provides significant side benefits, such as less air and water pollution, and the creation of high quality community living. Any increase in the share of trips taken by transit reduces infrastructure costs.

### Investing in sustainable development saves money.

A 1995 Canada Mortgage and Housing Corporation study compared costs of conventional development with those of sustainable development (one with denser development and a broader mix of housing types and land uses) on a 338-hectare site in Nepean. The study showed the total lifecycle (75 years) cost of sustainable development to be 8.8 per cent less than conventional development. Further, more than 70 per cent of these savings were on public utilities, such as roads, stormwater management, transit, water, policing and sanitary sewers. In short, investing in sustainable development rather than conventional development saves money.

### 6. First Five-Year Capital Budgetary Forecast (2002-2006)

The first five years (2002-2006) of the ten-year forecast period (2002-2011) have been planned in detail. The five-year forecast is based on the 2002 Capital Budget and Four-Year Forecast adopted by Council in March 2002. Some changes have been made to the Capital Budget and Forecast using the most current information available. Despite this careful planning, the City’s budgetary environment is expected to change during this forecast period. These changes will result in revisions to priorities. Projects summarized in Table 3 represent what City staff knows at this time.

Projects have been divided into four categories: lifecycle, growth, ongoing projects, and new initiatives. (Project lists and summaries are included in Appendix 5.) In July 2002, Council directed staff to bring forward a five per cent overall reduction in the 2003 capital envelope, reducing this envelope to $476 million. Final results of this directive will be included in the draft 2003 budget submission.

### Table 3

<table>
<thead>
<tr>
<th>2002-2006 Forecast Expenditures By Category</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>Total</th>
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<tr>
<td>Lifecycle</td>
<td>232</td>
<td>254</td>
<td>308</td>
<td>238</td>
<td>248</td>
<td>1,280</td>
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<tr>
<td>Growth</td>
<td>149</td>
<td>130</td>
<td>216</td>
<td>93</td>
<td>82</td>
<td>670</td>
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<tr>
<td>Ongoing Programs</td>
<td>35</td>
<td>35</td>
<td>42</td>
<td>40</td>
<td>38</td>
<td>190</td>
</tr>
<tr>
<td>New Initiatives</td>
<td>105</td>
<td>64</td>
<td>54</td>
<td>58</td>
<td>30</td>
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<tr>
<td>Total</td>
<td>521</td>
<td>483</td>
<td>620</td>
<td>429</td>
<td>398</td>
<td>2,451</td>
</tr>
</tbody>
</table>

The total of this program exceeds the five-year program in the adopted 2002 Capital Budget and Four-Year Forecast by $42 million. This increase is composed of three major components:

- The Emergency Medical Services Facility is expected to be a public-private partnership. The City’s 2002 budget included this project at a zero net cost. In this report, a gross cost of $20 million has been included in expenditures, and P3 funding applied to result in the same net zero capital cost.
- The Southwest Transitway Extension increased by $14 million.
- Park development increased by $6 million.

### 6.1 Lifecycle Maintenance (2002-2006)

Lifecycle maintenance accounts for 52 per cent of the capital forecast. Expenditures on lifecycle maintenance over the next five years will be determined by affordability. Over time, however, spending levels should increase to a level required to maintain the City’s assets. Lifecycle maintenance is divided into five categories: fleet, property and facilities, information technology, transportation and environmental infrastructure, and water and sewer infrastructure.
**Fleet**
From 2002 to 2004, replacing articulated buses will be a priority. Replacement costs should be $24 million in 2002 and $5 million in 2004 (see Appendix 4.2). Spending on other fleet vehicles should increase from $36 million in 2002 to $55 million in 2006, lowering the percentage of over-age vehicles in all classes.

**Property and Facilities**
Spending on property and facilities is forecast to increase from $28 million in 2002 to $38 million by 2006. This increased spending should reduce the deferred maintenance backlog over the short term and eliminate it by 2011.

**Information Technology**
Spending on information technology lifecycle maintenance is forecast to increase from $23 million in 2002 to $28 million in 2006. Appendix 4.3 outlines replacement measures to be implemented from 2002 to 2006.

**Transportation and Environmental Infrastructure**
Spending on transportation infrastructure includes roads, sidewalks, transitways and solid waste facilities. Spending on these programs is forecast to increase from $57 million in 2002 to $67 million in 2006; much of this increase will go to road reconstruction and rehabilitation.

**Water and Sewer Infrastructure**
Water and sewer programs include maintenance of the City’s water distribution and collection network and its wastewater treatment system. Some of the essential components of these systems require extensive rehabilitation and are included in upcoming forecasts. Replacement of the 85-year-old transmission mains from the Lemieux Island Water Purification Plant and the Combined Sewer Area Operational Control Tunnel account for $91 million in this period. The control tunnel is an integral component of the combined sewer replacement strategy, needed to satisfy Ministry of Environment requirements. The alternative—continued sewer separation—would cost substantially more.

**6.2 Growth (2002-2006)**
Growth represents 27 per cent of expenditures over the first five years of the planning period. This figure is based on current needs, official and master plans, and the growth forecast. Spending levels in this category differ significantly from year to year. The 2002 Budget and 2003 Forecast includes many of the SuperBuild projects listed in Appendix 3.1. A substantial spending increase in 2004 is the result of several major projects: a new transit garage to accommodate fleet growth; new pools and ice pads; and transportation projects identified in current plans.

Other growth projects include pipe infrastructure to service urban development and large-scale step-like expansions to water and waste treatment facilities. For instance, a major expansion of water filtration capacity at the Lemieux Island Water Purification Plant is required to meet expected increases in demand. The R. O. Pickard Environmental Centre (ROPEC) also may require expansion. The growth forecast assumes continued use of the Trail Road waste facility, but does not include other waste disposal options should the province deny its approval.

**6.3 Ongoing Programs (2002-2006)**
Ongoing programs include transportation, utility, and environmental programs. Transportation programs include pedestrian accessibility, cycling facilities, on- and off-street parking facilities, street lighting, traffic management, traffic control and safety, transportation demand management, and transitway improvements. Utility programs include water quality and environmental compliance, flow monitoring, wastewater facilities upgrades, recycling bins, and household special-waste mobile depots.

Programs related to property and facilities include retrofitting for changed uses, and improving efficiency, accessibility and security. Also included in ongoing programs are community-related programs such as park improvements, sports field development, capital partnerships, affordable housing and childcare capital grants.

These programs are forecast to remain at consistent expenditure levels over the first five years of the planning period.

**6.4 New Initiatives (2002-2006)**
New initiatives are forecast to include: an emergency medical services facility; an emergency medical services advanced-care training program; an emergency and disaster response program; relocation of employment and financial assistance offices; a south-central district library; the police strategic staffing initiative; solid waste management alternatives; and enhanced waste diversion. In 2002 and 2003, specific transition-related projects of $68 million and $15 million are also forecast.

On the water and sewer rate supported side, anticipated regulatory changes over the first five years of the planning period will likely involve major projects like: ROPEC regulatory impacts; water purification plant water-quality improvement program; and water purification plant waste management. In addition, new initiatives resulting from the Safe Drinking Water Act remain unknown.
7. Year Five to Year Ten Capital Projections (2007-2011)

The specific amounts and timing of capital projects within the 2007 to 2011 capital spending envelopes are not as predictable as the forecasts for earlier in the planning period due to uncertainties of future City priorities. Accordingly, all numbers identified for this period should be treated as illustrative rather than precise. As well, until the Official Plan and its accompanying growth plans are completed, the 2007-2011 forecast has been projected by program rather than by project (see Appendix 5.3). Estimated total spending is shown below.

<table>
<thead>
<tr>
<th>Category</th>
<th>2007-2011 Projected</th>
<th>Average Estimated Annual Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lifecycle</td>
<td>$1,705</td>
<td>$341</td>
</tr>
<tr>
<td>Growth</td>
<td>$1,365</td>
<td>$273</td>
</tr>
<tr>
<td>Ongoing Programs</td>
<td>$293</td>
<td>$58</td>
</tr>
<tr>
<td>New Initiatives</td>
<td>$343</td>
<td>$69</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$3,706</strong></td>
<td><strong>$741</strong></td>
</tr>
</tbody>
</table>

7.1 Lifecycle Maintenance (2007-2011)

The lifecycle maintenance forecast has been designed to eliminate deferred maintenance and show lifecycle expenditures at recommended levels as described in Section 5. As such, spending on lifecycle maintenance is shown as increasing from $248 million in 2006 to an average of $341 million each year between 2007 and 2011 to meet these recommended levels.

<table>
<thead>
<tr>
<th>Area of Lifecycle Responsibility</th>
<th>2006 Expenditures</th>
<th>2007-2011 Average Annual Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Property</td>
<td>$29</td>
<td>$38</td>
</tr>
<tr>
<td>Asset Management</td>
<td>$55</td>
<td>$85</td>
</tr>
<tr>
<td>Fleet</td>
<td>$28</td>
<td>$26</td>
</tr>
<tr>
<td>Information Technology</td>
<td>$67</td>
<td>$85</td>
</tr>
<tr>
<td>Transportation</td>
<td>$55</td>
<td>$86</td>
</tr>
<tr>
<td>Water and Sewer</td>
<td>$14</td>
<td>$21</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$248</strong></td>
<td><strong>$341</strong></td>
</tr>
</tbody>
</table>

Deferred maintenance on City properties, facilities and vehicles is expected to be completed by 2011. Deferred maintenance levels for transportation, and water and sewer infrastructure will be included in the long-term strategy for asset management report.

Information technology lifecycle spending levels are forecast to have reached recommended levels by 2006. Lifecycle maintenance levels for transportation, and water and sewer infrastructure are expected to reach their recommended levels by 2007.

A key requirement is the continued refinement of integrated management techniques and resulting programs to ensure appropriate rehabilitation is undertaken both for linear assets and potable water and stormwater and wastewater treatment facilities. These techniques and programs form the basis of asset management reviews now underway. Based on a straightforward value analysis, therefore, 2007-2011 values provide a realistic attempt to forecast necessary funding to meet lifecycle needs commencing in 2008.

7.2 Growth (2007-2011)

Growth requirements between 2007 and 2011 will be speculative until the City has a new Official Plan. Where and how growth will take place has not yet been determined.

The City’s capital forecast assumes the new Official Plan will allow the City to promote less capital-intensive growth. Any potential savings from this approach are anticipated to accrue to the transportation envelope of funds. Notwithstanding any savings, a significant requirement is expected to exist for infrastructure to support projected urban growth. The total estimate for growth is $1.365 billion for 2007 to 2011 compared to $670 million for 2002 to 2006.

The capital forecast assumes new facilities would be provided to maintain existing per capita levels of facility space. Facilities include pools, arenas, community centres, parks, cultural facilities and libraries. Other growth-related infrastructure projects and priorities will become clearer as the growth plans are adopted by Council.

7.3 Ongoing Programs (2007-2011)

Expenditure levels for ongoing programs are expected to increase between 2007 and 2011, and new program types may be added. Spending on community-related programs is estimated to increase from $10 million in 2006 to an average of $20 million each year between 2007 and 2011. Transportation programs, such as area traffic management and intersection improvements, are expected to increase from $14 million in 2006 to $20 million each year from 2007 and 2011. Expenditures on property and facilities programs are expected to increase from $9 million to $11 million. All program increases are projected in response to anticipated community needs.

7.4 New Initiatives (2007-2011)

Tax-supported new initiatives decrease from an annual average of $48 million between 2002 and 2006 to $37 million each year between 2007 and 2011. This decrease results from completion of transition projects. Tax-supported programs include projects such as new facilities not driven by growth.
Rate-supported new initiatives will increase from $7 million in 2006 to $30 million each year between 2007 and 2011. Enhancement to the water treatment process using ultraviolet light has been identified in anticipation of more stringent requirements in the future. Also, increased capacity for aeration tanks at ROPEC has been identified. Timing of the aeration tanks may be influenced by provincial regulations. A program for biosolids volume reduction in response to community concerns is included in this period, as well.

Long-range financial planning in water, sewer and waste will continue to be influenced by new and emerging guidelines, standards and regulations. It is expected that regulatory efforts will continue to move forward to promote environmental and public health. Estimates have been included concerning both water and wastewater treatment plants and any anticipated regulatory changes. The regulatory scope, impact and timing for a number of new items of legislation, however, are not yet known. These variables, therefore, could impact long-range financial requirements.

Where it is not constrained by overriding regulations from the provincial or federal levels of government, costs can also be influenced by policy decisions of Council. Beneficial reuse of biosolids, waste diversion goals, and rural servicing options are examples of issues that may have significant cost impacts.

It is also difficult to anticipate any specific programs that may be downloaded, although experience indicates any new downloaded responsibilities will not come with appropriate revenue streams. As a result, any added responsibilities could also have significant cost impacts.

### 7.5 Infrastructure Standards

Infrastructure standards drive the cost of projects and the overall capital program. Standards include frequency of major repair or replacement, quality of materials, and design components (functional versus "nice-to-have"). Project estimates include contingencies that vary considerably. These contingencies can represent a significant component of project costs.

Are the City’s standards too high? Are its programs too expensive? Are its program costs higher than other comparable municipalities? A review of standards, comparing them with other similar municipalities and taking into account relevant factors, would help answer these questions and assist Council to identify areas of capital program cost reductions.

### 8. Future Operating Budgets

An accurate long-range financial plan includes a thorough analysis of pressures on future operating budgets. A careful examination of operating budgets includes a review of impacts resulting from the implementation of future capital programs, and capital financing required to support future capital programs.

#### Base Operating Impacts

Over the City’s ten-year planning term, City programs and services face a number of funding pressures. First and foremost are inflationary pressures. Each year, the cost of goods and services needed to provide programs and services increases. Inflationary pressures add approximately $24 million annually to the budget. Collective bargaining with City employees will also cause service costs to rise.

The impact of population growth on the operating budget must also be considered. Population growth causes increased demand for services, and translates into a number of new requirements: new roads, streetlights, parks, sidewalks, water mains and sewers, community facilities, recreation programs, new ambulances. As such, population growth and economic development place additional pressure on the City’s tax rate. Growth pressures average $10 million per year.

#### Socio-demographic Trends

Between 2002 and 2011, the City will face many important social and demographic challenges. These challenges include an aging population, increased homelessness, the affordability of housing, and concerns surrounding personal safety and security.

In 2001, 88,000 of the City’s population were 65 years of age and over; this figure is expected to rise to 124,000 by 2011, an increase of 40 per cent. As a result of this aging population, the City’s health and social services needs will rise at a faster rate than previously experienced.

The City also enjoys greater ethnic diversity as more immigrants from Asia, South America and Europe make the City their home. Moreover, the influx of migrants (people moving from another country or province to the City) is expected to increase threefold over the next ten years—from 7,600 in 2001 to 21,000 in 2011.

Over time, additional outreach services will be required to help integrate these new residents. Furthermore, to keep pace with the City’s changing population, services must be tailored to community needs, including increased investments in health and long-term care, recreation and programming for seniors, specialized services for newcomers, and increased community funding for newcomer-serving agencies.
Addressing homelessness and providing adequate access to affordable housing will continue to be significant challenges for the City. A clear and demonstrable need for additional affordable housing—especially rental housing—is evident in the City. As a result of extremely low vacancy rates and a limited supply of new rental units, market rents have risen substantially (see Appendix 1.3). While this has resulted in a backlog of renters already experiencing affordability problems, continued household growth and low construction rates will only exacerbate the problem.

Pressures resulting from the changing face of the City are difficult to estimate, as they will depend on the precise nature of those changes and City Council's direction at the time.

**Future Capital Program Impacts**
Capital projects often generate additional operating costs. As growth leads to the purchase of additional buses, construction of new community centres, and development of new recreational facilities, for example, so too do these kinds of projects require additional funding to deliver and manage new programs and services, and to maintain and repair new facilities, equipment and vehicles. Based on the projects identified in the City’s long-range financial plan, operating costs could increase by over $100 million over the ten-year planning period.

**Capital Financing Envelope**
Contributions to capital reserve funds, including debt charges, in the 2002 operating budget total $273 million. Decisions surrounding the capital forecast and the pay-as-you-go policy could have an impact on this amount. Current funding levels cannot support the capital programs planned for the next ten years.

**Property Tax and Rate Implications**
Council reduced the property tax rate in 2001 and froze the rate in 2002, primarily through a combination of amalgamation savings and assessment growth. By 2003, the City’s operating budget is forecast to achieve a projected $77 million in amalgamation savings. In 2003, however, amalgamation savings and assessment growth alone will not be sufficient to offset budget pressures. Council will examine the anticipated shortfall during the 2003 budget review process.

City water and sewer operations have also benefited from the efficiencies and savings of amalgamation. Legislative and regulatory changes in the areas of health, safety and environmental concerns, however, increased the costs of providing water and sewer services.

**Tax-Supported Projections**
Existing tax rates will generate new tax revenue based on assessment growth. From 2001 to 2003, this growth combined with amalgamation savings have enabled the City to absorb a significant amount of inflationary and downloading pressures to achieve Council’s budget objectives. In the ensuing years, however, the ability to freeze property taxes at this level will be increasingly difficult given the significant budget pressures discussed in previous sections.

**Rate-Supported Projections**
Based on expected increased consumption, the amount of annual revenue generated from current water and sewer rates will grow. As with programs funded from property taxes, the ability to maintain future water and sewer rates at current levels will be difficult given projected operating budget pressures and anticipated legislative changes.

## 9 City Revenue Sources

Previous sections have outlined a number of pressures forecast on the City's operating and capital budgets, and capital expenditure requirements over the next ten years. The City’s challenge over this ten-year period will be to balance deferred lifecycle maintenance and unmet growth infrastructure needs with a desire for ongoing programs and new initiatives. Expenditure requirements are increasing as well; therefore, revenue sources to fund these requirements must be identified and established.

**Property Taxes**
The City’s major source of revenue is property tax. This revenue includes payments in lieu of taxes paid by other levels of government. The City’s property tax base is the value of all property as assessed in accordance with legislation set by the province. The City then sets its property tax rate. Total property taxes are the amount of revenue generated by this rate placed on the value of assessed property. These taxes account for 57 per cent of the City’s operating budget, which includes contributions to the City’s capital program and debt charges.

> Property taxes are an ineffective method for continuing to fund the bulk of services that municipalities deliver.

Most experts agree that property taxes are an ineffective method for continuing to fund the bulk of services municipalities deliver because they:

- Do not necessarily reflect residents’ ability to pay;
- Are a poor method of funding income redistribution programs, such as Ontario Works and social housing; and
- Hamper the global competitiveness of municipalities.

Municipalities in Canada do not possess the authority to address the problems associated with property taxes and must, by law, continue to rely on these taxes as a primary source of revenue.

**Development Charges**
Development charges are fees collected by municipalities, under authority of the Development Charges Act of 1997, to offset capital costs incurred to support growth-related infrastructure. Local governments in Ottawa enacted bylaws under this legislation and established fees based on the services and levels for their respective jurisdictions. Fees apply to all forms of development and are collected when building permits are issued. The City collects $60 million each year through development charges.
Development charges do not recover growth costs in full.

While available to offset growth costs, development charges do not recover these costs in full. For example, extensions of the City’s arterial road network and transit service are constructed primarily to serve the needs of growth areas. These extensions, however, also benefit established areas. As a result, a percentage of these infrastructure costs must be deducted from the total project cost and collected from the existing tax base. This percentage varies from project to project.

Recently, the Regional Development Charges bylaw was amended to address a significant shortfall in the collection of charges for roads and structures infrastructure. A review of the bylaw indicated that, under current rates, a portion of the funding necessary to support the capital program was being collected. An amendment that took effect August 1, 2002 increases rates to allow for collection of an increased share of the total estimated amount of capital required over the 20-year work plan. New revenue for 2002 and 2003 is estimated at $20 million.

Development charges can be used as an incentive to implement Council policy. For example, fees may be waived to support objectives such as development of non-profit housing, mixed-use or intensification at transit stations, and development in downtown and urban growth centres. It is important to note, however, that shortfalls arising from these reductions must be compensated through property taxes.

A significant shortfall in development charge revenue remains when these revenues are compared with the capital program costs of growth. The primary reason for this shortfall is the continuation of the discretionary discount for non-residential development. Although the recent amendment resulted in this discount being reduced on a city-wide basis, the amount collected still represents less than half the amount required to support the capital program. The consequences of this shortfall in revenue has been a delay or, in some cases, a reduction in the scope of major capital projects. This has resulted in an inability to meet growth requirements.

Development charges for the non-residential sector are not likely to recover the full share of development costs attributed to that sector. The charge that would be levied at the full theoretical charge would be so large that it would impede development and reduce job creation. A significant amount of development costs, therefore, will always be borne by the tax base. It should be recognized that the non-residential sector does pay a higher tax rate than the residential sector under existing property tax policy. Accordingly, new non-residential growth will provide substantial additional tax revenues to the capital program. Over time, a higher taxation level will offset the recognized shortfall of capital costs. The segregation of the property tax rate into a capital rate and an operating rate will facilitate this recovery of capital costs from new non-residential development.

User Fees
Fees are charged to users of many City services to cover part or all of the costs of providing these services. Examples include transit fares, recreation program fees, and childcare fees. One important factor in determining user fee amounts is whether all residents, regardless of income, have access to these services. In 2002, user fees funded 18 per cent of the City’s operating budget.

User fees also include utility charges such as water rates and sewer surcharges that are included on residents’ water bills. Water rates are set at a cost per cubic meter and take in all costs associated with treating and delivering drinking water, including direct operating, administrative overhead, and capital costs.

All operating, overhead, and capital costs of the City’s sewer utility, including wastewater and stormwater collection and treatment, are recovered through a sewer surcharge. The sewer surcharge is calculated as a percentage of the water rate and is then added to the water bill. The 2002 increase in the water rate resulted in increased sewer surcharge revenue, which has been applied as contributions to the capital program to assist with large lifecycle maintenance and regulation-driven projects coming on-stream. Costs of growth-influenced capital projects recovered through development charges are exceptions to full cost inclusion for both utilities.

The City has begun a process that will harmonize user fees. An overarching policy to address the foundation on which these fees are based must be developed and all fees reviewed.

Transfer Payments
The City administers several provincially mandated programs. A number of these programs are partially funded by the province through a cost-sharing arrangement, including Ontario Works, public health, child care and land ambulance. The City no longer receives transfer payments from the federal government. The federal government does, however, provide funding for the City’s homelessness initiative. In 2002, these provincial and federal subsidies combined funded 16 per cent of the City’s operating budget.

Other Revenues
Various other revenue sources are available to fund City programs. These sources include investment income, fines, property sales, and penalties and interest. Overall, total revenues from these sources constitute nine per cent of the City’s annual operating revenues. Fees are also charged for a number of services the City regulates, such as business permits, as well as taxi, animal and marriage licensing. These fees are used to offset regulation costs, and not as a source of general revenues.
10. Federal and Provincial Programs

Ontario municipalities receive no stable funding for infrastructure from the federal or provincial governments. Instead, these levels of government are providing short-term, program funding on a project-by-project basis. Although these funds allow projects that may otherwise not be affordable to move forward, they are unreliable and are developed outside of local government’s priorities. The current programs, outlined below, have a three- to ten-year window.

The Federal Government’s Urban Initiative
The Prime Minister’s Caucus Task Force on Urban Issues was created in May 2001 to develop an urban strategy for the federal government. The Task Force’s interim report acknowledged the problems facing municipalities. Given the limitations imposed by the property tax model, cities struggle to fund programs and infrastructure construction required by economic growth. The Task Force acknowledges the federal government has a critical role to play in supporting sustainable growth in Canada’s cities.

The interim report’s recommendations included establishing stable national funding programs for transit, affordable housing, and major building projects such as sewer and water systems. The Task Force’s final report is due before the end of 2002.

SuperBuild Millenium Partnership and Canada Ontario Infrastructure Program
The SuperBuild Millenium Partnership and the Canada Ontario Infrastructure Program are multi-year, province-wide programs that distribute funds on a relatively short-term, project-by-project basis. Although these programs provide the City with a welcome revenue source, the City has been forced to shift some of its priorities to take advantage of available funds.

The SuperBuild Millenium Partnership is a five-year, provincial initiative that each year directs $250 million to strategic infrastructure projects in eight major urban centres located outside the Greater Toronto Area. A $70 million funding envelope has been allocated to the City. In January 2002, the province designated $25 million for the Ottawa Congress Centre, and up to $45 million for several transportation improvement and expansion projects.

In 2000, the Government of Canada and the Government of Ontario created the Canada Ontario Infrastructure Program. Under this program, the federal government funds one-third of total eligible costs for projects approved by the province. This six-year program is administered by SuperBuild Corporation. (Details of this program can be found in Appendix 3.1) Federal and provincial revenues from future programs have been included in the City’s long-range financial plan at $15 million per year from 2006 onward.

Transit Investment Partnership
Under Transit Investment Partnership (TIP), the Government of Ontario announced that it will share the costs of inter-regional transit projects in municipalities outside of the Golden Horseshoe region over the next ten years up to a total of $250 million. The City submitted an application for $121.1 million over five years to fund rapid transit projects. (Details of the City’s submission can be found in Appendix 3.2). On August 16, 2002, the Government of Ontario announced that it will fund one-third of some projects for a total of $59 million.

Projects submitted for TIP funding will be put forward again as long-term projects in phase two of the TIP application process. The City assumes this program will continue and the federal government will provide a one-third share in 2004 and in the years to follow. As a result, 66.7 per cent grant funding has been applied to transit improvement projects between 2004 and 2011.

Transit Capital Renewal Program
Another component of the provincial plan is the Transit Capital Renewal (TCR) program. This program provides funding for transit fleet replacement and for vehicle refurbishing to extend vehicle life.

In February 2002, the province announced $100 million to be shared by 65 municipalities. Ottawa’s share of this fund—$12,869,717—has been applied to capital programs for bus replacement and refurbishing. The capital forecast assumes that the TCR program will cover one-third of transit renewal funding requirements over the forecast period.

Canada Strategic Infrastructure Fund
In August 2002, the federal government announced a new $2 billion fund for highways and railways, local transportation, tourism and urban development, water and sewage, and high speed Internet service. Under this program, public transit has been identified as a priority. The City has not designated its share to specific projects, as insufficient program details and criteria are available at this time. This revenue, however, has been applied on a general basis to fund the tax-supported capital program.
11. Potential New Revenue Sources

A single, comprehensive development charge bylaw would allow the City to budget and finance an additional annual commitment, beyond previous years’ base operating budgets. P3s, however, require careful assessment by all parties. This is due to a number of factors, notably the initial formation of a P3, its management, and a transfer of assets to fund it. Distribution of risk and an array of other financial issues must also be addressed. Development of successful, enduring P3s can be complex, requiring careful assessment by all parties. This is due to a number of factors, notably the initial formation of a P3, its management, and a transfer of assets to fund it. Distribution of risk and an array of other financial issues must also be addressed.

Public-private sector partnerships are effective tools to address budgetary demands.

Public-Private Sector Partnerships

Public-private sector partnerships (P3s) are effective tools to create imaginative and cost-effective service delivery structures. P3s should not, however, be viewed as measures to be applied in all circumstances. Rather, P3s are mechanisms to achieve specific objectives. As such, no two P3s are exactly alike.

When structured properly, P3s provide public services throughout the term of a contract. Moreover, they are effective in establishing long-term relationships between public and private sector partners, encouraging valuable and enduring cooperation. Ideally, P3s are most effective when a private-sector partner invests directly in the service it provides and, as a result, enhances service quality, develops additional services, and achieves greater efficiencies over time.

There are many kinds of P3s: design-build; design-build-finance; design-build-finance-operate; and design-build-finance-operate-transfer. Prior to the development and implementation of P3s, each must be assessed—first with regard to the City’s goals and objectives, and then with respect to the risk tolerance and financial structure of the partnership itself.

While there are no firm rules governing when to utilize a particular P3, some projects are more suited to certain types of partnerships. For example, design-build P3s are appropriate when projects are large and complex, require different construction methods and materials, and involve complex production schedules.

Design-build P3s are also suited for projects in which it is relatively easy to assess the quality of the finished product, for projects that are relatively passive in nature, and for projects not subject to short-term lifecycles. These partnerships also maximize access to private sector experience, reduce construction time, provide single-point accountability, and result in fewer construction claims.

Development of successful, enduring P3s can be complex, requiring careful assessment by all parties. This is due to a number of factors, notably the initial formation of a P3, its management, and a transfer of assets to fund it. Distribution of risk and an array of other financial issues must also be addressed.

Nevertheless, combining the expertise of both the public and private sectors to deliver public services often results in lower overall costs to taxpayers. As such, P3s have received increasing attention from all levels of governments as a means to address budgetary demands.

Immediate construction of a community asset through private sector financing, in return for some form of annual payment or contribution by the City, is perhaps the most appealing feature of P3 initiatives. These initiatives are particularly attractive when access to capital dollars is limited. While P3s do not necessarily result in lower overall financial costs to the City, they can provide public facilities in a more timely fashion. P3s, however, require the City to budget and finance an additional annual commitment, above and beyond previous years’ base operating budgets.

The City will carry out a review of development charge bylaws to develop a single, comprehensive bylaw by August 2004.

Amalgamation has provided an opportunity to review existing development charge bylaws and determine ways of addressing the costs of growth. Starting in late 2002, the City will carry out a review of these bylaws to develop a single, comprehensive bylaw by August 2004. This review coincides with the expiry of the existing bylaws and will require establishment of service level standards for the City, along with preparation of a work plan and funding model to deliver required infrastructure. With amalgamation, all eligible costs can now be included in a single work plan, establishing a clear understanding of the future budgetary demands of growth.

Clearly, a key objective of the review will be to assess any impact of moving toward full recovery of eligible costs. Historically, rates have been set at a level lower than necessary to maintain affordability in the internal market and a competitive place in the external market. City Council’s current fiscal direction, supported by Ottawa 20/20 – Charting a Course, places fiscal sustainability as a top priority. A move toward a cost-recovery model will be a significant shift in the City’s approach to growth management. This model, however, will be more easily achieved in a single-tier governance structure.

According to this model, major growth projects in the capital plan that are not currently included in a development charge study or bylaw are included in the upcoming bylaw update. These projects, therefore, are shown as development charge funded to the limit possible under legislation. Revenue projections have been increased accordingly.

Public-private sector partnerships are effective tools to address budgetary demands.
Normally, though, properly structured P3s result in lower overall costs to municipalities. Indeed, most P3s allow for user fees or alternative revenue sources that cover all, or part, of related capital and operating costs. Moreover, the City can offer added value to P3s by supplying development property, changing zoning designations, waiving development fees, assuming some risks, and creating strong financial covenants to attract additional financing. Additionally, private sector partners possess project-specific expertise, offer greater flexibility in meeting procurement and resource needs, and are able to access particular financial tools, such as asset depreciation, which are not available to the public sector.

Five criteria are being suggested to Council to identify possible P3 projects for the City. First, projects must already be outlined in the City’s five-year capital plan. Second, private sector partners must either add value to a project or create a new revenue stream to reduce the City’s net contribution. Third, projects must leverage existing City assets, services and abilities to reduce the need for capital funds. Fourth, in return for ongoing annual funding support from the City, projects must reduce or eliminate the need for initial capital investment by the City. Fifth, projects must represent an acceptable risk to the City and meet overall City objectives.

Development of successful public-private partnerships is a complex process requiring intense effort. It would be premature at this early stage of the long-range planning process for City staff to identify a comprehensive list of potential P3s projects or calculate the specific benefits that would accrue to the City from them.

As a shareholder, the City should expect to receive a return on its investment. As such, City staff asked the City’s fiscal agent, CIBC World Markets, to determine what Hydro Ottawa could be expected to generate in terms of dividends. CIBC World Markets compared dividend structures of a number of utilities to calculate Hydro Ottawa’s expected rate of return. In making its recommendation, CIBC also reviewed Hydro Ottawa financial forecasts to include any of the utility’s capital requirements that require funding. CIBC’s recommendation to the City is as follows:

Based on current forecasts, we believe that Hydro could embrace a policy which would pay the City dividends in 2004 and beyond at the dollar equivalent of 60% of net income. If Hydro’s capital expenditures were to grow more rapidly, a lesser payout could be considered. Conversely, if Hydro’s spending proves less ambitious than forecast, either the dividend policy could begin a year earlier or a special dividend could be paid in 2004.

We believe that such an approach to dividends would be prudent for Hydro and fair to the City in that it would evolve into a return on the City’s investment that would compare favourably with dividend returns being received elsewhere in the industry.

CIBC’s analysis forecast a dividend flow outlined in the following table:

<table>
<thead>
<tr>
<th>($ Thousands)</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income</td>
<td>3,246</td>
<td>3,003</td>
<td>17,646</td>
<td>17,038</td>
<td>20,430</td>
<td>24,058</td>
</tr>
<tr>
<td>Dividends at 60% payout</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>10,223</td>
<td>12,258</td>
<td>14,435</td>
</tr>
<tr>
<td>Interest</td>
<td>11,000</td>
<td>16,400</td>
<td>16,400</td>
<td>16,400</td>
<td>16,400</td>
<td>16,400</td>
</tr>
<tr>
<td>Total Revenue</td>
<td>11,000</td>
<td>16,400</td>
<td>26,633</td>
<td>28,658</td>
<td>30,835</td>
<td>30,835</td>
</tr>
</tbody>
</table>

A cautionary note must be raised. Since Ontario’s electricity industry operates in a regulated environment, regulatory changes can affect rate structures and profitability. Accordingly, dividend revenue should not be considered guaranteed revenue. Instead, dividend revenue should be committed only to those capital projects that could be deferred should funding be unavailable.

As the sole shareholder of Hydro Ottawa, the City always has the option to sell. Given the provincial requirement to claw back one-third of the sale price through transfer taxes, however, this is not an option City staff would recommend.

Between 2002 and 2011, Hydro Ottawa is forecast to contribute over $270 million in interest earnings and dividends, at current rates, towards the City’s capital needs.
Hydro Ottawa is expected to provide approximately $30 million per year of interest earnings and dividends between 2007 and 2011—revenue that could be allocated toward a capital shortfall. In summary, between 2002 and 2011, Hydro Ottawa is forecast to contribute over $270 million in towards the City’s capital needs.

**A New User Fees Policy**

Recovery of some or all capital costs could assist in reducing the City’s funding gap; however, no standard approach exists to determine the amount of direct and indirect operating and capital costs the City should recover through user fees. Currently, most fees simply pay for some direct programming and operating costs; overall, these fees do not recover any capital costs associated with service delivery.

The Government of Ontario retains considerable power over municipalities’ abilities to establish fees. The new Municipal Act, that comes into force on January 1, 2003, will allow the province to restrict user fees and will require municipalities to adhere to guidelines on how fees are approved. In addition, the new law will include reporting requirements.

The province has already filed two regulations on fees under this new act. The first regulation concerns fees and charges not covered in the Planning Act, and introduces new criteria and processes local governments must follow when implementing these fees and charges. Fees for wastewater collection and disposal, sewers, water consumption, fire protection permits and inspections, and police will be limited to cost recovery and subject to strict process rules. The regulation, however, does not define cost recovery. Further, under this regulation, municipalities must give 21 days notice and hold at least one public meeting before passing a bylaw implementing these types of fees. All other municipal fees will be subject to less stringent notice and disclosure rules, and will not be limited to cost recovery.

The City needs a revenue policy that institutes clear standards for program and service fees and rates. The second regulation maintains business license exemptions for certain business classes. The section in the new act governing license fees requires that the total amount of fees charged for a class of business must not exceed cost recovery.

The City needs a revenue policy that institutes clear standards for program and service fees and rates. Fees can be established for a number of purposes, including:

- Recovering a portion of service costs;
- Providing access to services not otherwise affordable to some residents;
- Remaining competitive within a local market; and
- Rationing use of municipal facilities.

The policy would identify which costs are to be recovered through fees while taking into account the purpose for which fees were established.

**Debt**

A long-term goal of the City should be to effectively manage debt. A debt eligibility policy should be established that identifies projects for which debt financing could be utilized. This strict definition of eligible project types, however, should be flexible during the first five-year period.

Recommended situations where debt could be most effective are outlined below.

- Many of the projects related to growth are now financed by development charges to varying extents. In the case of many city-wide services, development charges capture only a portion of the full costs of growth. The portion of growth costs not captured by development charges forms a draw on the City’s capital financing. Since these projects serve new growth areas and will serve future population in addition to the existing population, these costs should be eligible for debt financing. The debt charges created by these projects will be paid through an expanded tax base, including the new growth areas, and reduce net costs borne by the existing taxpayers.

- In some instances, projects required to service growth are required in advance of development. In these cases, even if development charges recover 100 per cent of the development cost, the City absorbs the carrying costs of a project unless a developer has front-ended project financing. While City policy should require developers to finance these projects under a front-ending agreement, some projects, such as water and sewer plants, are likely to be borne by the City. Accordingly, these types of projects should also be eligible for debt financing and the full cost related to the debt recovered from development charges.

- There may be situations where non-traditional infrastructure, which is partially or primarily funded by other levels of government, requires a large capital investment. Since this type of project would likely have a long benefit period, it may be desirable to spread costs over a longer period through the issuance of debt. This type of situation would be rare and would be used for an initiative like rapid transit, or to leverage other private sector funding or government funding, such as the original Canada Ontario Infrastructure Works program.
Cities Cannot and Should Not Fund Growth Alone

In February 2001, The Ottawa Partnership, (TOP) Ottawa’s economic advisory group, commissioned KPMG to study ways the federal and provincial governments could invest in urban economic growth. The report—Towards a Partnership to Invest in Economic Growth: Ontario and Federal Government Tax Revenues from the City of Ottawa—states that 93 per cent of new tax revenues generated by economic activity and growth in the City go to the federal and provincial governments.

In May 2002, the Federation of Canadian Municipalities (FCM) appeared before the House of Commons Standing Committee on Finance and presented its case for urban renewal: A New Deal for Cities: On the Road to Fiscal Sustainability. A key concern expressed by the FCM was the urgent need for municipal governments to be granted new tax room. The FCM’s position echoed calls from several prominent institutions—including the Conference Board of Canada and the Toronto-Dominion Bank—to provide new sources of funding to Canada’s municipalities. All agree existing municipal revenue streams have not kept pace with the requirements of Canada’s cities.

The economic benefits accrued to provincial and federal governments through the collection of income, consumer and employment taxes are widely recognized to be a direct result of the work of municipalities. While the United States and European governments have recognized the value of investment in urban infrastructure, Canadian federal and provincial governments have not yet taken the same approach.

This must change. As the TD Economics report A Choice Between Investing in Canada’s Cities or Disinvesting in Canada’s Future states:

If Canadians have any hope of raising their living standards above US levels over the next 15 years, then the status quo is not an option. A new way of thinking is urgently required—one that puts the affairs of cities front and centre on Canada’s economic and policy radar screen.

A number of potential revenue sources need to be made available to the City, many of which are already available to Canadian municipalities outside of Ontario. These revenue sources include a hotel tax, fuel taxes, provincial and federal sales tax exemption, shares of income tax revenues and vehicle registration fees, taxation of off-street parking lots, and land transfer taxes.

A hotel or motel occupancy tax is an excise tax levied on occupants of hotels and motels. This tax would be charged principally to visitors, who use services provided by the City. In Canada, this tax is levied in Vancouver and Montreal, and is permitted by legislation in Manitoba. In the City of Vancouver, the province sets a two per cent tax rate on hotel occupancy. In 2001, this tax raised an estimated $5.4 million in additional revenues for Vancouver.

Revenue streams associated with this tax vary according to economic conditions. A two per cent tax rate would raise an estimated $4 million for the City of Ottawa. This tax could be used either in a general manner or dedicated to specific priorities, such as tourism promotion or cultural programs.

- A fuel tax is an excise tax levied on gasoline consumption. Funds generated from this tax could be dedicated to transportation purposes, such as renewal and expansion of the City’s transit system. One option would see the City receive a share of the gasoline tax now collected by the federal and provincial governments. Because the tax would be collected under agreement with the federal and provincial governments, the City’s cost of administering the tax would be minimal. Further, the tax would generate stable and reliable funding. Since the tax would work much like a grant, however, allocation of tax funds could be reduced by the federal or provincial government during poor economic times or as a result of a shift in policy.

An alternative method would allow the City to levy the tax based on the City’s expenditure needs, but within specific bounds established by the federal or provincial government. Since the City would set its own tax rate, this approach would give it considerably more autonomy. For example, the Government of British Columbia permits both Vancouver and Victoria to collect fuel taxes. The tax rate is fixed by these cities, but any rate changes must be cleared by the provincial government. In Ottawa’s case, the tax could be collected by an existing agency, such as Canada Customs and Revenue Agency.

Revenue generated by fuel taxes is currently available to the cities of Vancouver, Victoria, Calgary, Edmonton and Montreal. The fuel tax share that Victoria and Vancouver receive is 11 cents per litre; for Calgary and Edmonton, the share is 4.5 cents of the provincial fuel tax. The Government of Alberta will reduce this share to 1.2 cents in 2003. Montreal receives 1.5 cents per litre. In each case, rates are set by the provincial government, which collects fuel tax revenue and transfers it to the cities. A five cent per litre share of fuel taxes in Ottawa would raise an estimated $60 million.

- Exemption from provincial sales taxes (seven per cent) or the goods and services tax (GST) (the City currently pays three per cent net) would reduce the cost of all purchases made by the City and ease budgetary pressures. As municipalities are unable to pass on the GST charged to them, the City of Ottawa taxpayers pay approximately $14 million in GST annually. If exempted, municipalities could direct these savings to pay for increasing costs of growth.
• Allocation of a share of income tax revenues would mean an increase in revenue to the City as economic activity grows. Manitoba, for instance, transfers to municipalities two per cent of personal income taxes and one per cent of corporate income taxes on a per capita basis. Income tax revenue could help offset the cost of infrastructure construction. One per cent of personal income tax revenue would represent an additional $21.7 million for the City.

• Vehicle registration fees could be collected by the City to help pay for transportation projects. Montreal, for example, receives $30 from each vehicle registered in the city. A $10 share of each vehicle registration fee would result in some $4.4 million for the City.

• A specific tax, or a share of sales taxes, collected from off-street parking lots could also be applied to the City’s transportation needs. Moreover, increasing the cost of parking would encourage transit use. Vancouver receives seven per cent of sales taxes charged at parking lots in the city.

• Land transfer taxes could be levied by the City to help pay for growth. Quebec and Nova Scotia, for example, have ceded this power to municipalities. No revenue estimates exist concerning a land transfer tax levied by the City.

Accessing these sources requires changes to legislative and other instruments under federal or provincial jurisdiction.

13. **Addressing the Capital Funding Gap**

The City’s capital funding gap has been calculated based on policies and revenues used to develop the 2002 Budget. These policies and revenues include:

• A capital formation envelope (debt charges and pay-as-you-go contributions), funded by the City’s tax base, which will remain the same over the planning period;

• Interest on Hydro Ottawa’s promissory note in 2002 and 2003 applied to fund the capital program;

• SuperBuild funding on approved projects;

• Transit Capital Renewal, an ongoing program funding one-third of eligible programs;

• Transit Investment Partnership, an ongoing program, with the federal government participation beginning in 2004, bringing senior government funding to 67 per cent on eligible projects; and

• An emergency medical services facility constructed through a public-private partnership.

Appendix 16 contains continuity schedules of capital funding-sources for tax, rate and development charge supported programs, including the expenditure levels described in this report. Cumulative funding gaps are shown in the next table.

<table>
<thead>
<tr>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007-2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>$M</td>
<td>$M</td>
<td>$M</td>
<td>$M</td>
<td>$M</td>
<td>$M</td>
</tr>
<tr>
<td>Tax Supported</td>
<td>(66)</td>
<td>(135)</td>
<td>(190)</td>
<td>(1,216)</td>
<td></td>
</tr>
<tr>
<td>Rate Supported</td>
<td>(53)</td>
<td>(63)</td>
<td>(80)</td>
<td>(428)</td>
<td></td>
</tr>
</tbody>
</table>

These models indicate the magnitude of the shortfall that exists between the capital program and available funding. The shortfall is substantial and cannot be solved simply.

<table>
<thead>
<tr>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007-2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>$M</td>
<td>$M</td>
<td>$M</td>
<td>$M</td>
<td>$M</td>
<td>$M</td>
</tr>
<tr>
<td>Tax Supported</td>
<td>(86)</td>
<td>(69)</td>
<td>(55)</td>
<td>(1,026)</td>
<td></td>
</tr>
<tr>
<td>Rate Supported</td>
<td>(73)</td>
<td>(10)</td>
<td>(17)</td>
<td>(348)</td>
<td></td>
</tr>
</tbody>
</table>

The above table shows the capital expenditure reductions that would be required in each of the tax and rate supported programs to achieve a $20 million ending reserve fund balance for each of the two programs.

**Options to Fund the City’s Capital Program**

Presented here are six options to fund the City’s capital program. The first three options are fully within the control of Council; the last three require actions by other governments.

**Option 1: Hydro Ottawa Interest and Dividends**

Use Hydro Ottawa revenue generated from interest and dividends. A portion of this revenue will fluctuate, which makes its use in the capital budget more appropriate than in the operating budget. This revenue should be used to fund tax-supported programs. Hydro Ottawa revenue will reduce the capital funding gap by the following amounts:

<table>
<thead>
<tr>
<th>Year</th>
<th>$ Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>-</td>
</tr>
<tr>
<td>2003</td>
<td>-</td>
</tr>
<tr>
<td>2004</td>
<td>26.2</td>
</tr>
<tr>
<td>2005</td>
<td>28.6</td>
</tr>
<tr>
<td>2006</td>
<td>30.8</td>
</tr>
<tr>
<td>2007 to 2011</td>
<td>157.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>242.6</strong></td>
</tr>
</tbody>
</table>
Option 2: Reduce Growth Share Borne
By Property Taxes
Reduce the impact on capital reserve funds by ensuring that
development charges are increased to recover as much of devel-
opments costs as possible. The City’s funding model assumes that
exercising this option will reduce the impact on capital reserves
by ten per cent of growth costs. If implemented, this option will
reduce the capital funding gap as outlined in the following table.

<table>
<thead>
<tr>
<th>Year</th>
<th>$ Million Tax Supported</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>-</td>
</tr>
<tr>
<td>2003</td>
<td>-</td>
</tr>
<tr>
<td>2004</td>
<td>15.9</td>
</tr>
<tr>
<td>2005</td>
<td>4.5</td>
</tr>
<tr>
<td>2006</td>
<td>4.0</td>
</tr>
<tr>
<td>2007 to 2011</td>
<td>95.3</td>
</tr>
<tr>
<td>Total</td>
<td>119.7</td>
</tr>
</tbody>
</table>

Option 3: Tax Rate for Capital
Reduce the capital funding gap by allocating a portion of taxes
from new assessment to the City’s capital budget. Rates should
receive similar treatment. Capital contributions received from the
growth in assessment should help pay for growth-related costs,
as well as recover a portion of growth costs that cannot be
recovered from non-residential development charges. The
following chart shows the incremental revenues that would
accrue to the capital fund if a separate capital tax and utility
rate were established.

<table>
<thead>
<tr>
<th>Year</th>
<th>$ Million Tax Supported</th>
<th>$ Million Utility</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>2003</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>2004</td>
<td>2.4</td>
<td>1.2</td>
</tr>
<tr>
<td>2005</td>
<td>4.8</td>
<td>2.5</td>
</tr>
<tr>
<td>2006</td>
<td>7.2</td>
<td>3.7</td>
</tr>
<tr>
<td>2007 to 2011</td>
<td>74.6</td>
<td>38.5</td>
</tr>
<tr>
<td>Total</td>
<td>89.0</td>
<td>45.9</td>
</tr>
</tbody>
</table>

A Summary of Options 1, 2 and 3
Together, these options would provide additional tax and rate
supported funding totalling $131.8 million over the first five
years of the ten-year planning period and $497.2 million over
the full period. Revised continuity schedules, which look at the
overall financial picture for the three funding sources with all of
the options included, are in Appendix 6. In addition two large
rate projects – Lemieux Island Transmission Lines and the Central
Storage Tunnel – are shown as financed by long-term debt.
This corresponds with the short-term recommendations on
debt funding of the capital program.

Expenditure Reductions Required
After Implementing Options 1, 2 and 3
To achieve Fund Closing Balances of $20 Million

<table>
<thead>
<tr>
<th>Year</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007-2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Supported</td>
<td>(40)</td>
<td>(30)</td>
<td>(12)</td>
<td>(695)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rate Supported</td>
<td>(3)</td>
<td>(25)</td>
<td>(365)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Even with this revenue, however, a shortfall is evident over
the long term. As such, unless other revenue sources become
available, the capital program will have to be reduced. Without
additional revenue, the City will have to review its growth
objectives and its ability to continue to provide services at levels
enjoyed today. Lifecycle spending levels will need to be slowed
to match funding capability, and new initiatives and programs
restricted to match available funding.

Growth spending will have to be reduced to lower future
operating costs. If not, standards within new growth areas
cannot be maintained at today’s levels. It is in this area where
other governments can provide help.

Option 4: Redistribute Funding Responsibilities
As outlined earlier, Ontario is the only province that requires
municipalities to fund significant health and social services
programs on a property tax base. Other provinces have abandoned this
requirement, allowing the property tax base to support only
those programs where municipalities have direct responsibility.
Transferral of full funding responsibility for health and social
services programs to Ontario would reduce the City’s tax levy
by $186.2 million and completely close the funding gap.

Option 5: Sharing the Tax Base
The federal and provincial governments receive dramatically
greater revenue resulting from growth than does the City.
A more fair revenue sharing arrangement would significantly
reduce the forecast funding gap.

The following table shows the impact of sharing existing
provincial and federal revenues.

<table>
<thead>
<tr>
<th>Item</th>
<th>Annual $ Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full refund of GST</td>
<td>14.0</td>
</tr>
<tr>
<td>Gas Tax (5 cents)</td>
<td>60.0</td>
</tr>
<tr>
<td>Vehicle license fee $10 per year</td>
<td>4.4</td>
</tr>
<tr>
<td>Transfer of funds equal to one per cent of personal income tax revenues for the City</td>
<td>21.7</td>
</tr>
<tr>
<td>Total</td>
<td>100.1</td>
</tr>
</tbody>
</table>
Revenue-generating powers noted in the table are examples of powers ceded by provincial governments to municipalities outside Ontario. Although any new revenue sharing arrangement with Ontario and the federal government will help the City over time, as long as legislative power over municipalities remains with the provincial government, any new revenue streams are inherently unreliable.

**Option 6: Annual Capital Surtax**
The City’s primary revenue source is property taxes. The following chart shows the effect of creating a one per cent capital surtax on the total property tax bill and a one per cent capital surtax on the utility bill. It should be clearly understood that this solution impacts the ability to raise these rates to find additional operating budget solutions.

<table>
<thead>
<tr>
<th>Year</th>
<th>$ Million Tax Supported</th>
<th>$ Million Utility</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>8.2</td>
<td>1.6</td>
</tr>
<tr>
<td>2003</td>
<td>16.7</td>
<td>3.3</td>
</tr>
<tr>
<td>2004</td>
<td>25.5</td>
<td>4.9</td>
</tr>
<tr>
<td>2005 to 2011</td>
<td>268.5</td>
<td>49.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>318.9</strong></td>
<td><strong>59.7</strong></td>
</tr>
</tbody>
</table>

Inclusion of options 1,2,3,5 & 6 as new revenue sources still does not meet the capital funding needs. Potential new revenues from the senior levels of government (option 5) have been applied to tax-supported programs.

**Expenditure Reductions Required**
After Implementing Options 1, 2, 3, 5 & 6
To achieve Fund Closing Balances of $20 Million

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007-2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Supported</td>
<td>(32)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(316)</td>
</tr>
<tr>
<td>Rate Supported</td>
<td></td>
<td>(14)</td>
<td></td>
<td>(19)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


**The City’s Capital Budget Challenge**
The City’s capital program is determined by four key factors: the need to provide services to growth areas; the need to sustain services in established areas; the desire to improve service levels in established areas; and the need for lifecycle renewal of existing assets. Until additional funding is identified, however, the City’s current capital program cannot be afforded.

To stay within the City’s available capital funding, a significant component of budget processes from now on must involve identifying services that may be discontinued or privatized. A comparison of capital standards in other cities may also assist in the reduction of the spending requirements.

Even then, the property tax base alone cannot support the City’s capital program. As is clearly identified right across the country, to sustain the growth of Canada’s major cities, significant provincial and federal funding must be provided on a stable, long-term basis. If this funding is not made available, the City’s ability to grow is jeopardized. Moreover, if such funding does not materialize and the capital program is not reduced, the City’s revenue base must increase and a capital surtax would need to be considered.

**The City’s Operating Budget Challenge**
Expenditures within the City’s operating budgets are forecast to rise to meet the needs of rapid growth, to accommodate provincial downloading, to sustain the City’s high quality of life, and to preserve the City’s current infrastructure investment. Operating costs will continue to increase with population growth and inflation.

The City’s operating budget forecast identifies ongoing budgetary pressures on services. After more than ten years of reduced or frozen tax rates, however, it is increasingly difficult for the City to absorb new costs within its existing budget base. Further, future operating costs associated with new capital facilities and services, and their potential impact on tax or water and sewer rates, should be taken into consideration when approving the City’s capital budget. Future budget decisions will require a choice between tax increases and program reductions. To assist in this decision, a new program review process should be established. This process would see a thorough review of one department each year outside the budget process.
Policy Recommendations

1. Growth must pay its own way. Accordingly, development charges should be increased to the highest feasible level.

2. The City's tax rate should be split into two new rates: one for operating expenditures, and another for capital expenditures. This split establishes a direct link to the capital program through the tax bill and ensures that increases in property assessment are shared by operating and capital budgets.

3. The City's capital planning process should identify the true lifecycle cost of City assets. Further, over time, additional funding should be provided to increase pay-as-you-go financing for lifecycle projects.

4. A study of capital standards in other municipalities should be undertaken to determine if savings can be found through appropriate standard adjustments.

5. A new program review process should be established to provide a cyclical review of all departments, with one department being reviewed in detail each year.

6. A policy should be developed to identify the minimum closing annual balance for Reserve Funds to allow for reasonable financial flexibility.

7. To provide assistance to Council in its determination of capital priorities, future capital budgets should list projects by function and type using the following categories: growth, lifecycle, existing approved programs, and new initiatives. The City's capital program should be aligned with available funding on an annual basis. To identify possible reductions, a new step in the budget process needs to be put in place that will allow Council to determine overall funding priorities. Prioritization by Council should occur early in the budget process with priorities identified both by functional area and type. Capital projects identified between budget cycles should only be funded by substitution for another project within the same funding envelope.

8. Future operating costs for capital projects should be considered as part of the capital budget. Since these costs will carry over to future operating budgets, they must be clearly itemized to determine whether they will be covered by new money, or from within the existing tax base.

9. Projects that create additional infrastructure should also generate an added pay-as-you-go contribution. This added pay-as-you-go contribution should also be incorporated for all assets built by others but whose ongoing costs are assumed by the City. These costs should be summarized clearly, with detailed tax and utility rate implications part of the budget documentation.

10. The urban or rural transit levy should be earmarked for operating and capital requirements of the transit service (such as buses, garages and other services that directly support the operation) within either the urban or rural areas. As a result, all residents would contribute to future transit extensions in the same manner as they contribute to roads.

11. Long-term debt financing should be restricted to specific project types. Debt funding for lifecycle projects should be reduced and ultimately eliminated. Instead, debt financing should be employed on projects related to capacity expansion or growth, projects financed by development charges, future new non-traditional infrastructure projects, and projects tied to third party matching funding. These restrictions may have to be phased in to meet short-term budget challenges.

12. Public-private partnership opportunities should be identified and investigated in both the City's capital and operating budgets. Investigation of these opportunities should include a review of the City's capital plan to bundle capital works into packages that present design-build-finance opportunities to the private sector. Any costs or savings of these public-private partnerships should be identified in future budget documents.

13. The City should establish a revenue policy that sets standards for fees and rates of programs and services. This policy would identify which costs are recovered from fees. Currently, most fees simply cover direct operating costs. They do not recover any capital or operating costs of facilities. The City's funding gap can be reduced somewhat if City policy changes to recover some or all capital and operating costs. Regardless, the proposed revenue policy must be applied on a consistent basis for new programs.

14. A new federal/provincial/municipal funding formula and revenue-sharing agreement is required for Ontario's cities. Without a new revenue-sharing agreement, it may not be possible to support the current growth forecast. Support is required from upper levels of government to maintain the quality of municipal services. The City urgently requires a wider range of revenue-sharing options, rather than the regressive property tax it relies on now. These options include a share of gasoline taxes, a hotel occupancy tax, a portion of income taxes, exemption from federal and provincial sales taxes, a share of funds generated through vehicle licensing, and transferral of the provincial requirement to cost-share health and social service programs.

15. If new revenues are not forthcoming from the federal and provincial governments, a funding gap will remain. Council will have to look at a range of potential solutions to address the gap, including: cutbacks in programs, changes in standards, adjustments in service levels, application of new revenues, continued deferral of infrastructure, and limiting growth. If these solutions are not sufficient, tax and rate increases will be required.