# The Regional Municipality of York

Committee of the Whole
Finance and Administration
June 10, 2021

Report of the Commissioner of Finance

# 2021 Fiscal Sustainability Update

## 1. Recommendations

Council consider, as part of the 2022 Budget process, the establishment of an incremental and dedicated Rapid Transit Capital Levy, to help fund the non-growth portion of major new transit initiatives, such as the Yonge North Subway Extension and future Bus Rapid Transit expansions.

## 2. Summary

This report is to update Council on the long-term fiscal sustainability matters of the Region, describe key financial pressures that it faces, and outline some of the major funding and financing implications of the Yonge North Subway Extension (YNSE) and other potential major transit projects.

Key Points:

- Past decisions by Council and funding from senior levels of government helped to mitigate against the fiscal impacts of COVID-19 during 2020
- The continuation of pandemic-related cost pressures remains a risk for 2021 and 2022
- A key principle of fiscal sustainability is to ensure that adequate reserves are maintained
- The Region faces several long-term financial challenges, including:
    - Funding the infrastructure needed for future growth
    - Ensuring the Region is saving enough in reserves for existing assets and liabilities
    - Funding and financing, in a fiscally sustainable manner, major new capital projects such as the YNSE

# 3. Background

## Pandemic-related financial impacts were mitigated in 2020, but risks remain for 2021 and 2022

York Region, like all Ontario municipalities, has been reliant on senior government support to help with the extraordinary costs of responding to the pandemic.

A deficit was avoided in 2020 due Council's early decision to implement cost mitigation measures in response to the pandemic, as well as the successful advocacy by all municipalities for incremental COVID-19 related funding from senior levels of government.

Approximately $91 million of senior government funding was received by the Region for use in 2020, and additional of $103.5 million of committed funding from senior government is expected in 2021. A further $97-128 million of unconfirmed or conditional funding could also be available.

The full fiscal impact of COVID-19 in 2021 and 2022 remains to be seen but the Region will continue to manage through the reallocation and reprioritization of resources, efficiencies, service level adjustments, prudent risk management and use of reserves.

## Fiscal sustainability is about planning for the long-term

Fiscal sustainability is about making financial decisions using a long-term lens.

For York Region, the four principles of fiscal sustainability are shown in Table 1:

### Table 1

### Fiscal Sustainability in the York Region Context

| Principles |
|---|
| Keeping growth affordable and the Region's existing infrastructure in a state of good repair |
| Maintaining the Region's credit rating |
| Maintaining the fiscal flexibility to respond to the Region's changing needs and unforeseeable events |
| Treating current and future tax and ratepayers fairly |

York Region will be in a fiscally sustainable position when it can affordably accommodate the long-term needs of growth, while maintaining existing infrastructure in a state of good repair.

To afford these investments, ongoing reserve contributions are needed. These contributions not only allow the Region to avoid debt where possible, strong reserves also provide liquidity and financial flexibility, which proved especially important in coping with the financial impact of the COVID 19 pandemic.

Strong reserves are also very important to credit rating agencies and York's reserves underpin its Aaa credit rating with Moody's Investor Service and AA+ with S&P Global Ratings. These ratings help to keep the Region's cost of borrowing amongst the lowest of Canadian municipalities.

## The approved 2021 Budget continues to support fiscal sustainability

The Budget continued to make reserve contributions needed to fund the infrastructure in the 10-year Capital Plan without the need to issue any new tax levy debt. A reduced reliance on debt, in particular tax levy-supported debt, has been an important part of the fiscal strategy since its initiation in 2014.

## The Region's reserves are forecast to be almost $3.6 billion by the end of 2021 and most are at target

By the end of 2021, the Region is expected to have accumulated approximately $3.6 billion in reserves, as shown in Table 2. While most of these reserves are at target, there are gaps in the asset replacement reserves as well as the human resources reserves.

### Table 2

### Projected Reserve Balances as at Year-End 2021

| Reserve Balance ($Millions) | Tax Levy | User Rates | Development Charges | Other | Total | 2021 Target* |
|---|---|---|---|---|---|---|
| Asset Replacement Reserves | 1,288 | 615 | | | 1,902 | 1,960 |
| Growth Capital Reserves | 384 | | 327 | 79 | 789 | At Target |
| Debt Reduction Reserve | 294 | | | | 294 | At Target |
| Stabilization Reserves* | 111 | 75 | | 145 | 331 | At Target |
| Other Corporate Reserves | 103 | | | 2 | 105 | At Target |
| Human Resources Reserves** | 131 | | | | 131 | 283 |
| **Total** | 2,311 | 689 | 327 | 227 | 3,554 | |
| **Share in Total** | **65%** | **19%** | **9%** | **6%** | **100%** | |

*Includes the Pandemic Management Reserve, which is expected to have a balance of $89.4 million

**Target represents employee benefit liabilities. Expected annual costs are included in approved budget figures (e.g., WSIB, LTD, health & dental)

Source: York Region Finance

## In 2020, York Region executed a Preliminary Agreement with the province on the Yonge North Subway Extension

On May 28, 2020, York Region Council authorized the execution of the "Ontario-York Region Transit Partnership Preliminary Agreement" with the Province to work towards delivering the subway project. While the formal contribution agreement has yet to be negotiated, staff estimate that the Region could be asked to contribute over $1 billion towards this project.

## An Ontario-York Region governance framework has been in place for the YNSE since the signing of the Preliminary Agreement

The Preliminary Agreement ensures that the Province of Ontario, York Region and the City of Toronto are fully committed to working together in partnership to build the YNSE. Through this agreement, the Region committed to serve as the "one window" and York is responsible for directly coordinating with the Cities of Markham, Richmond Hill and Vaughan.

Working groups have been created within the York one window to address project objectives. Where a decision is required or an issue is escalated for decision making, these matters will be brought to the YNSE Executive Group for resolution. In the instances where the issue involves the Province, the YNSE Executive Group will bring them to the Province for resolution.

## Metrolinx's Initial Business Case for the YNSE recommends the project's advancement to the next stage

In March 2021, the YNSE project reached an important milestone when Metrolinx released the Initial Business Case (IBC) for the project. This confirmed the YNSE's strategic economic value and recommended that it advance to the next stage, which is the Preliminary Design Business Case (PDBC). There were three alignment options presented in the IBC, and all could be delivered within the $5.6 billion budget with three or four stations, depending on the chosen alignment.

While a major portion of York Region's contribution to the $5.6 billion will be funded from development charges, the balance will need to be funded from non-DC sources that may represent a tax-levy pressure for the Region over the coming years.

## The 2021 Regional Fiscal Strategy included a resolution seeking legislative change to help fund and finance the YNSE

On March 25, 2021, Council adopted the 2021 Regional Fiscal Strategy, re-affirming its commitment to achieving long-term fiscal sustainability. As part of this approval, Council also adopted a resolution requesting legislative changes that would help ensure that developments fairly contribute to the cost of the YNSE, and would also improve the Region's capacity to repay the debt that would likely be incurred to finance a growth project of this size and scope.

These requested changes were:

- Amend the *Development Charges Act, 1997* ("Act") to treat the Yonge North Subway Extension as a discrete service, not limited to a 10-year planning horizon
- Repeal section 26.2 of the Act, or exempt the Yonge North Subway Extension (as a discrete service) from the freezing provisions under section 26.2
- Extend the Region's growth-cost supplement for another 10 years

So far, as detailed in the memorandum from the Commissioner of Finance to Council on March 25, 2021, the Province has passed regulations to renew the Region's growth-cost supplement of its Annual Repayment Limit until 2031.

### The Federal Government has committed to funding 40% of the original capital cost of $5.6 billion

On May 11th, 2021, the Federal Government announced a funding commitment of $10.7 billion to support the delivery of the Province's plan to build four priority subways including the YNSE. The funding would be through the previously announced Investing in Canada Infrastructure Program. The renewed commitment from the Federal Government towards the YNSE is a major milestone for the project and would substantially improve the project's overall funding and financing strategy as the project progresses towards the next stage.

## 4. Analysis

### The Region faces a number of challenges to fiscal sustainability

In addition to COVID-19 pressures, the Region still has to manage a number of long-term challenges, including:

- Funding the infrastructure needed for future growth
- Ensuring the Region is saving enough in reserves for existing assets and liabilities
- Funding and financing, in a fiscally sustainable manner, new major capital projects such as the YNSE

## Funding infrastructure needed for future growth

### The Province anticipates York Region will attract the highest share of growth in the Greater Toronto and Hamilton Area

In the most recent provincial Growth Plan projections, the Province expects York Region to continue to be a high growth municipality, attracting approximately 22% of the overall population growth in the Greater Toronto and Hamilton Area through to 2051. This is slightly above Peel and Toronto's projected shares. In addition, the magnitude of anticipated growth in the Greater Toronto and Hamilton Area over the next 30 years is significantly higher than the past and the area is expected to add 3.4 million people over the next three decades, compared to a growth of 2.8 million people between 1986 and 2016.

To achieve what is envisaged by the Growth Plan, the Region is projected to grow by 26,100 residents (on average) each year to 2051. This is higher than the average level of growth the Region experienced between 1986 and 2020.

However, growth is cyclical, and the Region is in a period of slower than expected growth. Over the past 10 years, the Region grew by 16,500 residents per year. This level of growth was below historic averages and the Growth Plan forecast.

## Servicing the Region’s outstanding debt and the affordability of the capital plan, is predicated on robust growth

The affordability of the capital plan depends on achieving the projected growth as over half of the 10-year capital plan is allocated to growth projects. Development Charge (DC) collections are the main source of funding for these projects, and debt bridges the timing between when the cost of infrastructure is required and when the growth occurs. Over the next ten years approximately 90% of projected development charges collected by the Region will be required to service the Region’s debt repayments.

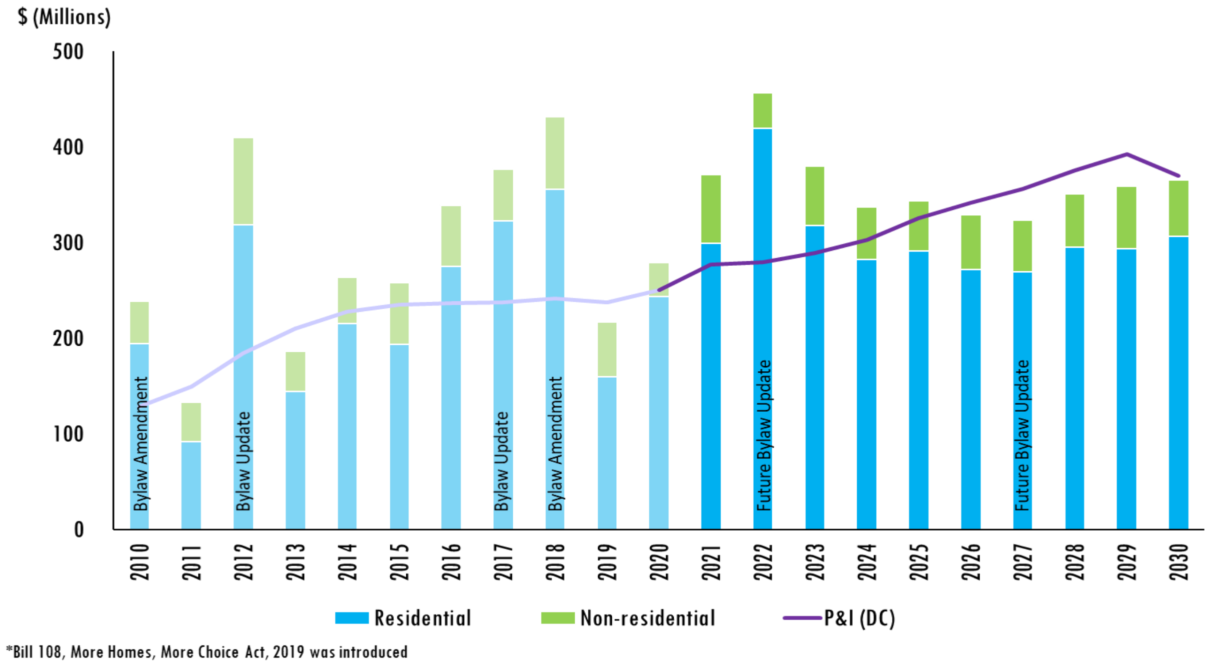
Figure 1 shows the relationship between the Region’s historical and forecast development charges versus debt repayments. The DC collections forecast is predicated on achieving and maintaining development activities at the pre-pandemic level (or approximately 7,900 units per year). At this level of growth, DC collections are expected to exceed principal and interest payments, which is critical to affording the capital plan. However, if the Region’ growth falls short of this level of DC collections, new growth-related infrastructure investment may need to be deferred.

In fact, based on the 2021 approved budget forecast, staff estimate that starting in 2026 there would be a few years where the forecast annual DC principal and interest exceeds expected DC collections. To repay debt in those years the Region would need to carefully manage the DC reserves and where necessary, defer new growth-related infrastructure until such time when expected growth and development generates sufficient development charge collections.

The amount of DCs recoverable and the pace of cost recovery for a major capital project such as the YNSE is an important consideration. This will be addressed later in this report.

COVID-19 has also had an impact:  DC collections were $279 million in 2020, which is approximately $80 million less than forecast. DC collections are projected to average $360 million per year and this assumes that the housing market and the economy recover in 2022.

**Figure 1**
**Historic and Forecast DC Collections and DC Debt Repayment**




Source: York Region Finance

## Phasing of urban expansion and integrated growth management will help support financial sustainability

The amount of urban expansion and associated population and employment growth to 2051 is unprecedented. Integrated growth management is one of the recommended policy directions of the Regional Official Plan, which could be achieved through phasing of infrastructure delivery. Phasing is a tool to manage the timing and location of growth over the extensive 30-year planning horizon and will require strong phasing policies in both Regional and local municipal official plans. The phasing of infrastructure delivery will help support the Region’s fiscal sustainability by allowing the Region to leverage existing infrastructure investments, stage and phase new development and infrastructure to manage debt levels, and align investments with the ability to recover DC collections and grow in a financially sustainable manner.

## Ensuring the Region is saving enough in reserves for existing assets and liabilities

Regional Council has made significant progress in building asset management reserves to support the Region’s growing asset management needs. Risks relating to asset failure are mitigated through condition and risk assessments, proactive maintenance programs and capital renewal programs. This approach achieves the defined levels of service throughout the asset’s life cycle and extends the investment to the full life expectancy of the asset.

The multi-year budget includes contributions to tax levy asset management reserves that average $180 million per year from 2021 to 2022. These contributions should ensure that the Region can meet its short-term asset management needs, but additional annual increases to contributions will be required to maintain the Region’s infrastructure in a state of good repair.

## Capital reserves funded by tax levy contributions are expected to be below their target in the next 10 years

The Region’s tax levy funded capital reserves are expected to be short of their target balances at the end of 2021, and the gap may increase over time. The projected reserve balances are shown in Figure 2 below. The increase in the reserve targets (the dashed line) is driven primarily by increasing asset management needs as the Region continues to add infrastructure to support its population growth.

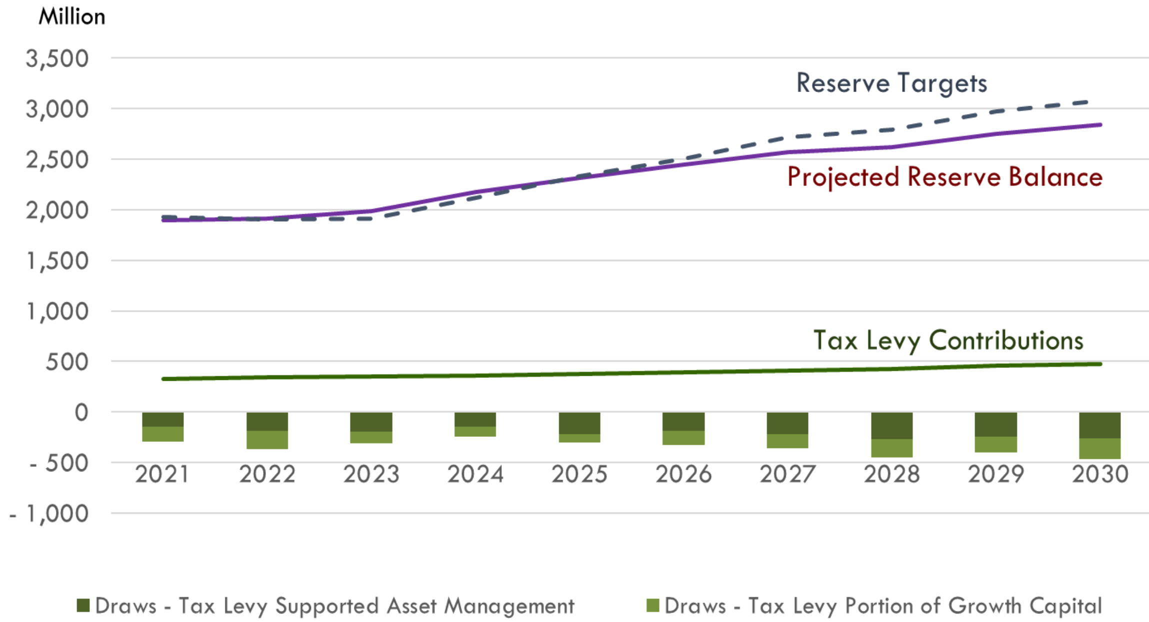
The projected reserve balances (purple line) shift from being at target today, to slightly below target in 10 years’ time. This is largely because asset management contributions, currently projected to grow at 3% per year plus assessment growth, are unlikely to keep pace with the growth of the Region's asset base.

This analysis has not yet factored in the YNSE requirements which means that higher draws from the tax levy reserves may be expected over the medium term.

A partial alternative could be to allocate all, or a part of the Federal Gas Tax funding received as a one-time top-up in 2021/2022 of $33.8 million towards asset management capital projects. This would reduce the amount needed for future asset management investments.

Another measure could be to redirect RCAR proceeds as they are repaid to asset management reserves. This could increase funding available for asset management by up to $200 million, though this funding would only begin in 2029 and take about 10 years to achieve.

**Figure 2**
**Potential Impacts on Tax Levy Capital Reserves**




### The Human Resources reserves are for contingencies

As shown in Table 2, the Human Resources (HR) reserves are forecasted to remain below their target. However, the gap shown is based on the difference between the current assets and the forecasted accounting liability for these benefits. The Region is not required to fund this gap and can instead choose to pay for benefit costs as they are incurred.

## Funding for new major capital projects such as the Yonge North Subway Extension

### The YNSE is not currently in the approved 10-year Capital Plan

The capital cost and financing charges for the YNSE have not been included in York Region's approved 10-year capital plan. This is because there is still a great deal of uncertainty with respect to the magnitude and timing of the cash flows, uncertainty around the project costs, and the treatment of the YNSE for development charge collections is still to be decided. For the purposes of financial modelling, staff have estimated that York Region's contribution would be up to $1.3 billion out of the total expected cost of $5.6 billion.

## The YNSE will be considered as part of the Region's 2022 Development Charge Bylaw update

Staff are updating the Region-wide Development Charge Bylaw. A new bylaw must be in place on or before June 17, 2022, and the YNSE will be considered as part of this update. Through the development charge update process, staff will determine the appropriate levels of statutory deductions (e.g., benefit to existing deduction, post period benefit deductions). These deductions determine the share of the subway costs that may be recovered through development charges in the 2022 bylaw. More details on the 2022 Development Charge Bylaw update can be found in the June report titled: 2022 Development Charge Bylaw – Status Update.

A major portion of York Region's contribution to the YNSE is expected to be funded from development charges - staff estimate that the range could be between 60 - 83%, with the balance funded from the tax levy. An indicative range of funding requirements are summarized in Table 3 below.

### Table 3

### Range of Capital Funding Requirements for the YNSE

| | Estimated Range | |
|---|---|---|
| Funding split assumptions | 60% DC<br>40% Tax Levy | 83% DC<br>17% Tax Levy |
| Expected York Region Total Contribution | $1.3 Billion | $1.3 Billion |
| Indicative split ($M) | $780 M DC<br>$520 M Non-DC | $1,060 M DC<br>$240 M Non-DC |
| Indicative Debt Servicing Costs | $100m/year (approximately $40m tax levy) | $100m/year (approximately $17m tax levy) |

Source: York Region Finance

For modelling purposes, staff assumed that the DC rates associated with the YNSE will be levied on a region-wide basis, and that the associated rate increases will come into effect in 2022, in accordance with the forthcoming DC bylaw update. The above analysis also assumes that the Region's population will grow by approximately 23,800 people annually over a 20-year period. This level of growth is similar to what was presented in the March 2021 Proposed 2051 Forecast and Land Needs Assessment Report . The assumed level of population growth is robust and is higher than the historic 10-year average of 16,500 residents per year.

## Financing some or all of the YNSE would result in a substantial increase in debt

The YNSE is expected to require a substantial amount of external debt financing. Even if the tax levy portion is funded directly from reserves, the DC portion will likely require substantial amounts of debt. This debt is because the money used to pay for construction is flowed much sooner than the DC collections that are used to fund the project. The extent of the debt financing would have implications for future fiscal sustainability, as development charges are predicated on the pace of growth.

For the purposes of the debt forecast, it is assumed the subway is treated as a discrete service for DC rate calculations and the DC rate freezing provision continues to apply. It is also assumed that 60% of the Regional share of the YNSE is eligible for DC recovery.

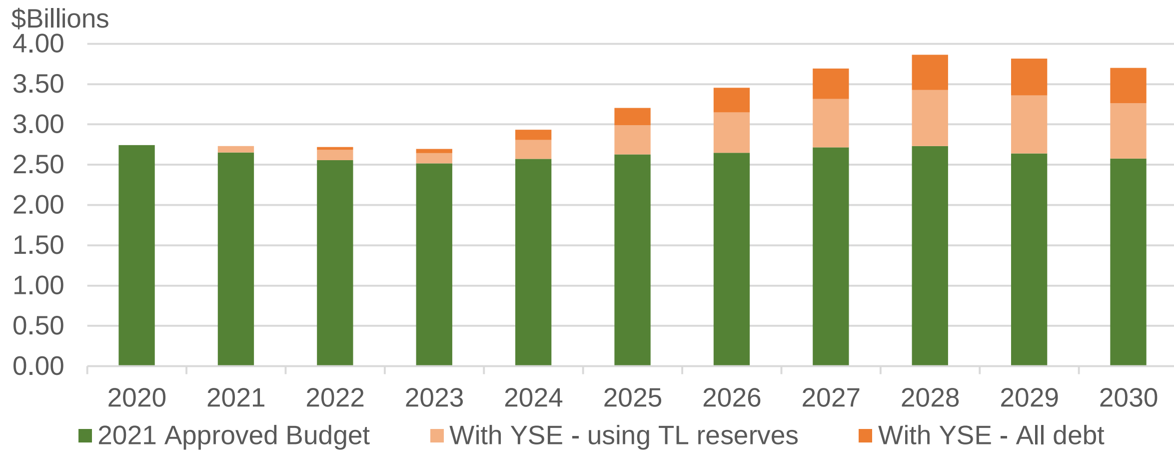
Figure 3 below shows two possible debt profiles. The first assumes the tax levy portion of debt is fully funded from reserves. If this were the case, preliminary modelling indicates that debt could peak as high as $3.4 billion in 2028, and principal and interest on the subway portion alone would be $60 million per year against DC collections of approximately $50 million per year. The second scenario assumes the entire contribution is debt financed. Here, debt could peak as high as $3.8 billion in the year 2028 with principal and interest for the subway being $100 million per year, $40 million of which would be supported by the tax levy.

Generally, a high level of outstanding debt and the corresponding annual debt requirements heightens the risk that future development charge collections may not be sufficient to cover the DC-funded debt repayments. Also, in either of the scenarios described above, there could be a risk of a downgrade in the Region's credit ratings.

**Figure 3**

**Projected Outstanding Debt with YNSE**

Based on 2021 Approved Budget




Source: York Region Finance

# Tax Levy implications of funding the Yonge North Subway Extension

## The Region's operating contribution to the YNSE is still to be determined

Although the City of Toronto/Toronto Transit Commission will be responsible for the day-to-day operations of the YNSE, it is expected that the Region will be contributing a share of the operating expenditures. As per the preliminary agreement[1], the Province intends to develop with the Region an operating funding agreement for the Project, which will specify the ongoing operating contribution required from the Region. The operating contribution requirement from the Region will likely have tax levy funding implications.

## The timing of contributions needed for YNSE could impact the ability to fund from reserves alone

The portion of the YNSE that is funded by the tax levy is estimated to range from 20% to 40% of the Region's total contribution (Table 3) and could be over $500 million.

Based on a targeted opening date in 2030, it assumed that the cash flow requirements for the YNSE are spread out between 2022-2030, and that funding would be contributed on a "pay-as-you-go" basis. However, the timing of the cash flows could have a considerable impact on the Region's reserve management strategy. If more money is required earlier than currently estimated, such as in the case of milestone payments, then tax levy supported debt issuance or temporary borrowing from other reserves may be needed.

Funding the entire tax levy requirement of the YNSE from currently planned reserves would reduce the reserves-to-debt ratio

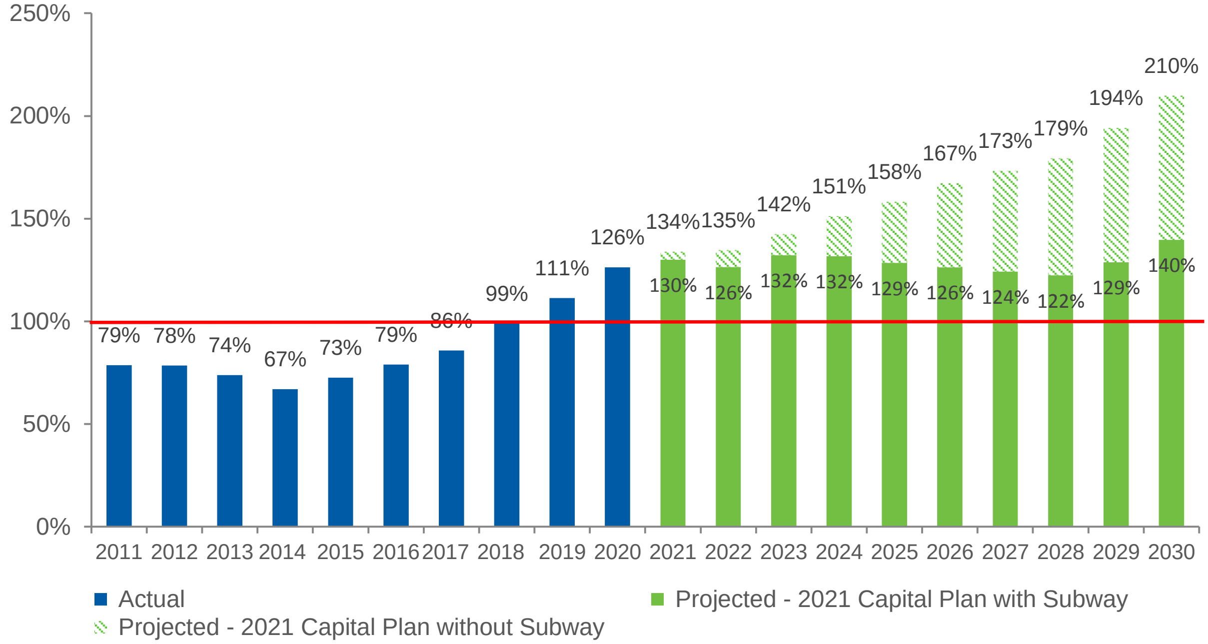
If the tax-levy funded portion of the YNSE costs is entirely funded from reserves, it would result in a substantial reduction in 2021 Budgeted reserves-to-debt ratio as shown in Figure 4.

[1] Province of Ontario-Regional Municipality of York Transit Partnership (Yonge North Subway Extension) Preliminary Agreement, page 5

**Figure 4**

**Actual and Projected Reserves-to-Debt Ratio**

Based on 2021 Approved Budget




Source: York Region Finance

Although the reserve to debt ratio is projected to remain above 1, it should be noted that a significant reduction in the level of reserves, could put the Region's long-term financial sustainability at risk. Strong reserve balances are an indication of liquidity and financial flexibility and is viewed as a major credit strength by the Region's rating agencies.

## A dedicated Rapid Transit Capital Levy would help fund the tax levy capital requirement of rapid transit projects such as the YNSE and future Bus Rapid Transit projects

To help fund the tax levy portion of rapid transit project such as the YNSE and future BRTs, Council may consider a dedicated Rapid Transit Capital Levy each year, starting with the 2022 Budget. While additional analysis will be required, a dedicated levy could allow the Region to avoiding having to issue tax levy debt to support major transit projects. Council would consider the quantum of any dedicated levy as part of the 2022 budget deliberations.

## Other municipalities use special tax levies to help fund major infrastructure projects

In 2013, City of Toronto Council approved a 1.6% special levy over three years from 2014 to 2016 to fund the Scarborough Subway Extension. In 2017, the City approved the City Building Fund Levy, which imposes incremental increases of 0.5% annually for five years to help fund priority transit and housing infrastructure projects. The levy has been subsequently extended to 2025 with additional incremental increases, resulting in a levy of as high as 10.5% in 2025.

The City of Ottawa has several dedicated levies to fund its services, including a transit levy. The transit levy was in place before 2001 and is reviewed annually as part of the budget process.

Finally, some of the local municipalities in York Region have also implemented an infrastructure levy to meet their capital needs, all of which apply to the entire local tax base.

### The Region’s fiscal plan will need to be very flexible given the YNSE

The forecasted debt projection and the reliance on development charge collections means that there could be a number of financial risks that will need to be carefully managed. For example, a shortfall in development charges due to lower than expected growth could mean that other growth-related projects in the capital plan may need to be deferred.

The YNSE is expected to benefit the Region’s population and employment growth for decades into the future and it remains a required priority transit project for the Region to achieve the Provincial Growth Plan targets. The challenge for the Region will be to fund and finance the project in a fiscally responsible manner that achieves the Region’s Strategic Plan priorities, while mitigating both short and long-term financial risks.

## 5. Financial

This report considers the short and long-term financial implications of the Region’s fiscal sustainability by exploring options to fund and finance the YNSE.

This report also highlights the increasing gap between the Region’s capital reserves and what is required in the future and suggests alternatives to reducing the gap which would have direct financial implications for the Region’s tax levy funding sources.

Finally, as a funding mechanism for major rapid transit initiatives such as the YNSE and future BRT expansions, this report recommends that Council consider the implementation of an incremental and dedicated tax levy to support Rapid Transit Capital Implementation. Council would consider the quantum of any dedicated levy as part of the 2022 budget deliberations.

## 6. Local Impact

Growth-related infrastructure is vital to the Region’s local municipalities. Any fiscal pressures that impact the timing delivery, maintenance and enhancement of this infrastructure must be monitored and managed.

# 7. Conclusion

Maintaining fiscal sustainability is a hallmark of the Region’s prudent financial management and is a key factor that contributes towards the Region’s strong and stable credit ratings.

This report recommends that Council consider directing staff to, as part of the 2022 Budget, add an incremental Rapid Transit Capital Levy beginning in 2022, to help fund major new transit initiatives, such as the Yonge North Subway Extension or future Bus Rapid Transit expansions.

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For more information on this report, please contact Edward Hankins, Director, Treasury Office and Deputy Treasurer at 1-877-464-9675 ext. 71644. Accessible formats or communication supports are available upon request.

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