The Regional Municipality of York

Committee of the Whole
Finance and Administration
June 16, 2022

Report of the Commissioner of Finance

2022 Fiscal Sustainability Update

1. Recommendations

1. Council endorse, as part of the 2023 Budget process, a continuation of the 1% annual increment to the Rapid Transit Infrastructure Levy (RTIL) for 2023 and 2024, to fund the tax levy contribution needed for the Yonge North Subway Extension.

2. As part of the 2023-2026 multi-year budget, Council consider further extending the 1% annual increment to the tax levy for 2025 and 2026, to help fund the tax levy portion of other major new infrastructure initiatives that were included as part of master plans, such as the future expansion of Bus Rapid Transit and Housing York Inc. development projects.

2. Summary

This is a mid-year update of the 2022 Fiscal Strategy for Council on matters that may have fiscal sustainability implications for York Region. It outlines the challenges associated with the funding of the pandemic, the expected impact of inflation, as well as future growth-related infrastructure and asset management needs.

Key Points:

- Fiscal sustainability requires stewardship and planning for the long term
- York Region continues to be engaged in the pandemic response and experience financial impacts from COVID-19 that will continue to affect costs and services into 2023, and potentially beyond
- Higher inflation rates have created short-term cost pressures, while the medium and longer-term implications remain uncertain
- The 2022 Development Charges Bylaw will help fund a larger share of the cost of growth-related infrastructure
- The Region's reserves are currently healthy, however there will be funding challenges to meet future growth and asset management needs

- A continuation of the 1% annual increment to the RTIL for 2023 and 2024 will be needed to fund the Region's tax levy contribution for the Yonge North Subway Extension (YNSE) project

- Extending the 1% annual incremental levy for 2025 and 2026 could help fund the new projects identified in infrastructure master plans, such as Bus Rapid Transit (BRT) and Housing York Inc. (HYI) projects

3. Background

Fiscal sustainability requires stewardship and planning for the long term

Fiscal sustainability requires making financial decisions using a long-term lens. The Fiscal Strategy strives to achieve long-term financial sustainability while maintaining a balance between the current and future needs of the Region, with a focus on the prudent management of the capital plan, reserves and debt. The principles outlined in Table 1 serve as a guide to achieving fiscal sustainability.

Table 1

Fiscal Sustainability at York Region

Principles
Keeping growth affordable and the Region's existing infrastructure in a state of good repair
Maintaining its AAA credit rating
Having the fiscal flexibility to respond to the Region's evolving needs and economic changes
Treating current and future tax and rate payers fairly

The Budget and Fiscal Strategy follow the fiscal sustainability principles outlined above

The Budget and Fiscal Strategy are two of the main policy tools that the Region uses to achieve fiscal sustainability.

Council's commitment to fiscal prudence to maintain a strong financial position has been consistently noted and recently recognized by the credit rating agencies. In 2021, the Region regained its AAA credit rating with S&P Global Ratings, despite the impact of the global pandemic when other organizations were either being downgraded or put on negative outlook. Their report highlighted the continued strong financial management of the Region as a contributing factor for their rating.

Notwithstanding, managing growth and other external factors will continue to present new financial challenges.

COVID-19 continues to affect some services being delivered

To date, the financial impact of COVID-19 has been fully covered through the Region’s internal mitigation strategies as well as by senior government funding. The most significant financial impacts so far have been for the Public Health response, including the mass immunization initiative, and reduced transit ridership. These impacts are expected to continue, in varying degrees, throughout 2022 and beyond.

Higher inflation rates have resulted in short-term cost pressures, while medium to longer term implications remain uncertain

Pandemic-related supply chain issues, pent-up consumer demand, lower interest rates and the war in Ukraine have combined to push inflation rates to levels not seen since the early 1990s. As a result, many operating programs and capital projects have been experiencing higher than expected cost increases in 2022. If higher inflation rates continue over the medium to longer term, there could be future fiscal implications.

The 2022 Development Charges Bylaw will help fund a larger share of growth-related infrastructure

In May, Council approved the Region’s new 2022 Development Charges Bylaw. Development charges are the main source of funding for growth-related infrastructure. As a result of recent legislative changes, the new bylaw allows for a larger share of eligible infrastructure costs to be recovered through development charges.

The Region’s reserves are currently healthy, however there will be funding challenges to meet future growth and asset management needs

The Region’s reserves are forecasted to be approximately $3.9 billion by the end of 2022. While majority of the reserve contributions are currently on target to meet their anticipated need, a higher level of contribution will be required to fund future asset management needs.

New projects identified in the master plans, once added to the 10-year Capital Plan, will require additional funding

Infrastructure master plans are being updated concurrently with the Regional Official Plan, which will be considered by Council for adoption in June 2022. The cost for any new or revised projects in the master plans that was not previously included as part of the 2022 10-year Capital Plan could require additional funding and/or have a negative effect on the previously forecasted debt levels.

4. Analysis

The impact of COVID-19 will continue to affect the cost of services at least into 2023

The 2022 Budget included $159 million in projected operating impacts from COVID-19 of which approximately $86.1 million is expected to be funded from senior levels of government.

Council established the Pandemic Management Reserve in 2020 to help fund one time and/or short-term pressures associated with the pandemic. This reserve is still expected to have a balance of $47.8 million at the end of 2022.

However, other pressures will continue to affect the Region's operations over a longer term. These include the $15.6 million 'structural gap' resulting from the use of the one-time revenue in 2021 to help reduce the tax levy increase during the pandemic as well as other permanent impacts on key operations as COVID-19 becomes endemic.

Additional funding from senior levels of government may be needed to help fund any significant ongoing COVID-19 costs should they extend to 2023 and beyond.

Sustained levels of high inflation could also impact the 10-year Capital Plan

In addition to the CPI impact on operations, higher inflation rates are also impacting the non-residential building construction price index, or NRBCPI (17.3% in the first quarter of 2022) which is used for estimating the cost of new infrastructure. Sustained high levels of inflation could create funding challenges when delivering the capital plan and for future capital budgets. Prolonged higher inflation on capital construction costs could consume more of the available room within the sustainable funding allocations guiding capital budget preparation, potentially requiring some projects to be moved to later years.

DEVELOPMENT CHARGES AND DEBT PROJECTIONS

Development charge collection forecast used for the 10-year Capital Plan is predicated upon achieving robust growth in line with the Region's Official Plan forecast

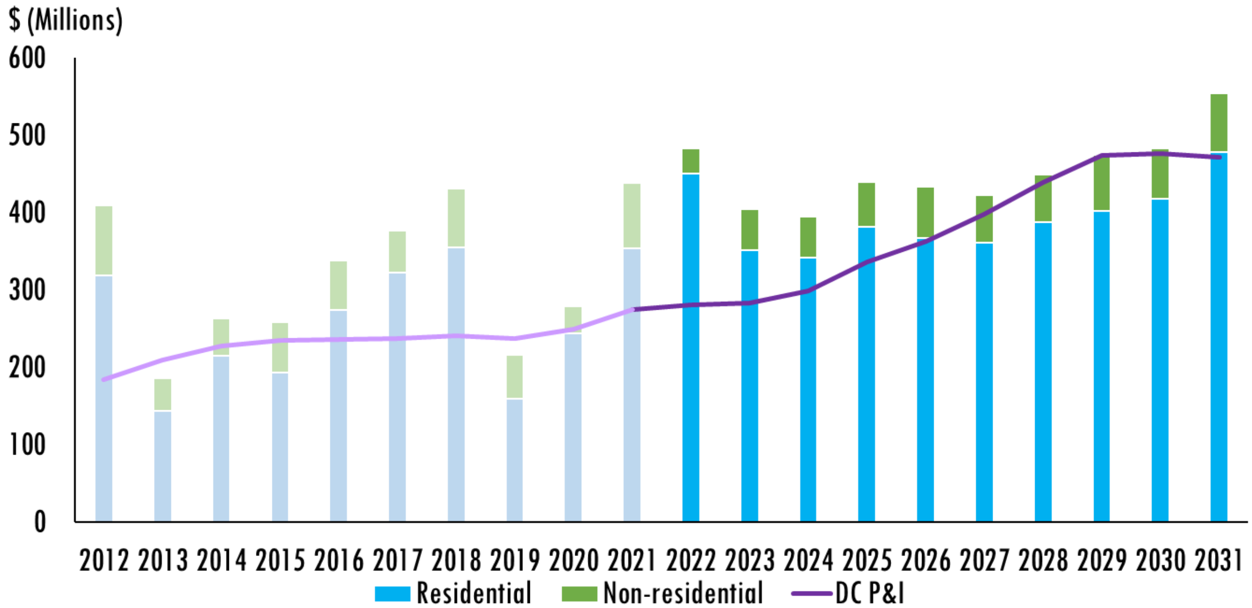
The 2022 Development Charges Background Study includes approximately $7.9 billion of eligible infrastructure costs and $2.0 billion for the debt currently outstanding. These costs could be recovered over the next 20 years if planned growth is fully achieved.

The DC collection forecast used for 10-year Capital Plan assumes residential development of about 8,200 units per year, similar to the level of housing starts achieved in the past 10 years and in line with the residential forecast contained in the Region's Official Plan. This forecast also assumes non-residential growth of 2.4 million square feet per year.

Average annual DC collections, over the next 10 years, are forecasted to be approximately $454 million, of which approximately 80% will be needed for the principal and interest payments on outstanding DC debt (Figure 1).

Figure 1

Historic and Forecasted Development Charge Collections and DC Debt P&I



If the forecasted growth does not materialize at the pace anticipated, there could a risk of lower than forecasted development charges being collected during this period. Prolonged periods of lower development charge collections could increase the amount of debt needed and would require the careful management of the capital plan to mitigate this risk.

Outstanding debt is expected to peak at $3.4 billion in 2031

Debt is used by the Region to finance the cost of growth-related capital projects between the time of their emplacement and the time that development charges have been collected for them.

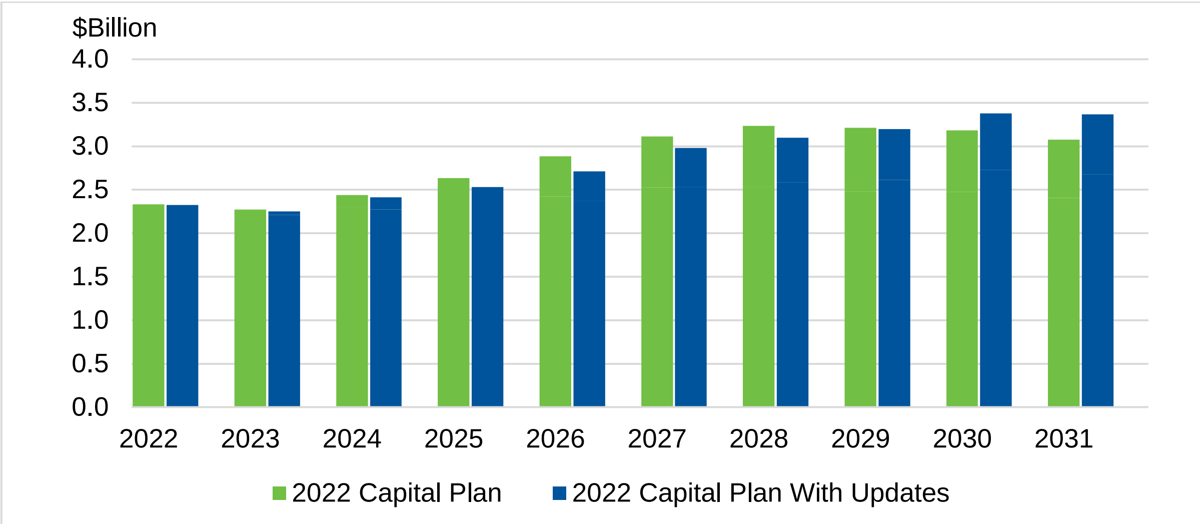
Figure 2 updates the debt forecast for the 10-year Capital Plan that was originally presented as part of the 2022 Budget with the funding available as a result of the approved 2022 DC Bylaw. Furthermore, updated cashflow estimates for the YNSE have been incorporated to reflect the latest information provided by Metrolinx. Finally, the debt servicing costs have been updated to reflect the most current interest rate forecasts.

As a result, net outstanding debt is now projected to be lower between 2022 and 2029, before increasing in 2030, and then reaching its peak in 2031. Peak debt is expected to increase by $132 million, from the previous forecast of $3.2 billion in 2028, to $3.4 billion in 2031.

Figure 2

Net Outstanding Debt Forecast

2022 Capital Plan vs. 2022 Capital Plan With Updates



Outstanding debt and annual financing charges have an impact on the Region’s credit ratings

One of York Region’s fiscal sustainability principles is to maintain its AAA credit rating. In their rating report, S&P set out its expectation that the Region should continue to proceed carefully with its capital spending program, making changes where appropriate, and continue to limit its debt level to below the peak in 2017. It also indicated that the rating would be lowered if York Region generated lower-than-expected revenue and if the debt level rose, leading to an interest burden above 5% of revenues.

Preliminary modelling on the debt forecast suggests that starting in 2027 the debt level would exceed the 2017 peak of $2.9 billion and the interest burden would exceed 5% of operating revenue towards the end of the 10-year forecast period, assuming an annual tax levy increase of 3% from 2023 onward.

Careful management of the timing for projects contained in the 10-year Capital Plan and associated debt levels and servicing costs will be required to help ensure that the Region maintains its AAA credit rating.

RESERVES AND ASSET MANAGEMENT NEEDS

Contributions to reserves are mostly on target to meet their intended need

As discussed in the Background section of this report, the total forecasted reserves are expected to be approximately $3.9 billion by the end of 2022, as shown on Table 2. While the contributions for most of the reserves are on target, the amount needed for future tax levy asset rehabilitation and replacement is below its target.

Table 2

Projected Reserve Balances as at Year-End 2022

Reserve	2022 Forecasted Balance ($Millions)	2022 Contribution On Target/Under Target
Asset Replacement Tax Levy	1,305	Under Target
Asset Replacement User Rate	757	On Target
Sub-total	2,062	
Growth Capital	807	On Target
Development Charges	373	On Target
Corporate Reserves	640	On Target
Total	**3,882**	

Source: York Region Finance

Annual reserve contributions are prioritized to ensure the growth component of the 10-year Capital Plan is fully funded in time for its planned expenditures. As such, the 2022 contributions toward growth capital, development charges and corporate reserves are on target.

Contributions to the asset management reserves allow the Region to maintain its past investments in a state of good repair

Through successive budgets, Council has committed to building asset management reserves that support the Region's growing asset management needs. Healthy reserve balances allow for asset rehabilitation and replacement without the need to issue new tax levy or user rate debt.

At approximately $2.1 billion, asset replacement reserves represent the largest reserve category, with about $1.3 billion for tax levy-supported assets and the remaining $0.8 billion for user-rate supported assets for water and wastewater services. These reserves are used to rehabilitate and replace the assets, with an estimated replacement value of over $16 billion as identified in the [2020 State of Infrastructure Report](). In addition, new assets with a capital cost of $4.9 billion are forecasted to be added over the next ten years for both tax levy and user-rate funded infrastructure. Eventually, nearly $21 billion of assets will need to be rehabilitated or replaced and the $2.1 billion currently held in the asset replacement reserves will need to grow to fund this.

Through the 2021 User Rate Study, Council approved a financial plan that will see the water and wastewater system achieve and maintain full cost recovery. This includes full funding for water and wastewater asset management, such that rehabilitation and replacement can be funded while adhering to the Fiscal Strategy's over-arching principle of inter-generational equity. The rate study also supports Council's commitment to fund asset management without issuing new user rate debt.

Increased contributions to tax levy funded asset replacement reserves will be required to fully fund future asset management needs while striving for inter-generational equity.

YNSE AND OTHER CAPITAL PROJECTS CONTAINED IN MASTER PLANS

A continuation of the 1% annual increment to the Rapid Transit Infrastructure Levy in 2023 and 2024 will be needed to fund the tax levy contribution for YNSE

The Region's estimated capital contribution towards the YNSE is approximately $1.12 billion, however this amount has not yet been finalized by the Province, nor does it include any amount towards the Region's (as a "funding partner") oversight costs.

The 2022 Budget approved a 1% annual Rapid Transit Infrastructure Levy (RTIL) to help fund the tax levy component of the Region's share of the YNSE capital cost. Over the next 10 years, this 1% RTIL could generate around $122 million in tax levy revenue. To fully fund the tax levy component, the 2022 Budget signalled a need to continue with additional 1% incremental increases of the RTIL for 2023 and 2024, which could generate a further $230 million by 2031. The total RTIL revenue of $350 million would cover the tax levy capital contribution for the YNSE as well as any "funding partner" costs.

The use and amount of contribution needed for RTIL will be reviewed each year as part of the budget as better information becomes available.

Additional funding could be required for new and revised capital projects identified in master plans

The Region's recent master plans identified the infrastructure needed to service its growth to 2051. These master plans are being updated concurrently with the Regional Official Plan.

The master plan update for Water and Wastewater did not add any new projects that would need to be included in the 2023 10-year Capital Plan.

The Housing York Inc. Master Plan includes an estimated $2.0 billion to develop 4,800 new HYI owned units and 792 replacements over the next 40 years. The approved 10-year Capital Plan from the 2022 Budget includes placeholder funding for new development and replacement. Approximately $350 million of additional funding over the next 10 years would be required to support HYI's growth plans to potentially deliver 1,530 new units and 322 replacement units. Based on the historical project funding, 30% of these costs will be funded through senior government grants and 70% by the Region.

Based on the 2022 Development Charge Bylaw, approximately $69 million in incremental DC funding and $176 million in new tax levy funding will be required over the next 10 years to implement this Housing program.

The Transportation Master Plan contains $1.32 billion for future BRT projects over the next 10 years

To expand the BRT network to service the Region's growth to 2051, a capital investment of approximately $5.4 billion will be needed over the next 30 years. It is estimated that $1.32 billion of this amount will be required over the next 10 years.

While bus rapid transit has traditionally been 100% funded by senior governments, it is anticipated that for future projects, a substantial contribution may be expected from the Region. Assuming a level of municipal contribution similar to the YNSE, or approximately 27%, the Region's estimated share for the bus rapid transit program over the next 10 years could be $373 million of which 82% is eligible to be recovered through development charges under the DC Bylaw. This would result in DC funding of $306 million, with $67 million being required from the tax levy over the next 10 years.

Expansion of the BRT network is dependent on prioritization and investment by senior levels of government. Given significant current Provincial investments in subway projects both in the Region and the City of Toronto, investment in future network will be phased over time subject to provincial funding commitments. Inclusion of the Region's share of Provincially led BRT projects in the 10-year roads and transit capital program will be reviewed annually and approved by Council.

A further incremental levy of 1% each year for 2025 and 2026 could be used to help fund new projects identified in infrastructure master plans

As described above, additional tax levy funding of $243 million may be needed over the next 10 years for new BRT and Housing York Inc. projects. By adding an incremental tax levy of 1% each year in 2025 and 2026 it could generate approximately $200 million of additional tax revenue by 2031 that could help fund these and other projects identified through the approved master plans.

5. Financial

This report updates Council on the Region's current financial position as well as the challenges to its long-term financial sustainability. The report describes the potential funding needs and impacts for the 2023 10-year Capital Plan to support future growth. It also highlights the growing gap between the current contribution to the asset replacement reserves and what will be needed for future tax levy asset rehabilitation and replacement.

As a part of the Regional Official Plan (ROP) update, a Fiscal Impact Analysis was also completed. This analysis is appended to the report seeking Council's adoption of the Regional Official Plan, which is also being considered at the June 16 meeting of Committee of the Whole.

Whereas this Fiscal Sustainability Update is based on results from the 2022 Budget and 10-year Capital Plan (as well as some known updates), the Fiscal Impact Analysis for the ROP is based on growth to 2051 as envisaged by the proposed ROP. Despite differences in the timeframe and assumptions underlying the two analyses, both indicate that the path to financial sustainability requires careful balancing of capital investments, reserves and debt, and that increased contribution to capital reserves is required to fully fund the lifecycle costs of existing and planned infrastructure. The phasing and aligning of infrastructure investment with actual pace of growth will be key to supporting these objectives.

6. Local Impact

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

7. Conclusion

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

This report provides a mid-year update of the 2022 Fiscal Strategy and updates Council on the Region's current financial position. It also outlines the challenges which could impact long-term financial sustainability.

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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