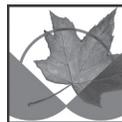


# COUNTDOWN TO ZERO: Balancing Toronto's Budget

Sheila Block

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# Executive Summary

The City of Toronto is not in a severe financial crisis and without options, as the rhetoric coming from the mayor's office would have us believe. Rather, city council has real choices before it. It can make choices that will support a city building budget: one that builds a more inclusive, more prosperous and healthier city for us all.

Each year, over the past five years, the City of Toronto has started its budget process with a budgetary shortfall of over half a billion dollars. And, in compliance with the law, every year the city brings the shortfall down to zero. It has done so without gutting city services or selling off valuable assets.

This year's budget cycle — that began with a budgetary shortfall of \$774 million — is no different. This initial shortfall is not a deficit, but simply represents the amount of ground that must be covered through the budgeting process to ensure the budget is balanced. In previous years, a combination of increased revenues, cost-cutting measures, transfers from other levels of government, and use of reserves have brought the budget shortfall down to zero.

What's different this year is that the actions of city council have worsened Toronto's fiscal challenges. Mayor Rob Ford's decisions to freeze property tax rates and cancel the Personal Vehicle Tax have cost the city \$132 million in revenues and have contributed to the 2012 budget shortfall.

This report shows how, without relying on transfers from other levels of government, city councillors can bring the budget deficit down to zero. Doing the same kinds of things that city council has done in the past can balance the city budget, with no need for drastic measures. Specifically:

- Measures already announced by the city (TTC fare increase and increases in revenues) will bring the deficit down by \$131 million;
- Reversing last year's ill-advised decision to freeze property taxes and increasing this year's property tax rate by 3 percent (a total increase of 6 percent, reflecting two years' worth of normal increases) would increase revenues by \$136 million;
- If the city matches the average amount it has saved over the last five years through cost cutting and efficiencies, costs will be reduced by \$98 million;
- Over the last five years, the surplus from the previous year has averaged \$181 million. Assuming this year is no different, that amount could be applied to this year's budget;
- Another \$188 million can be found by accessing the \$88 million from the 2010 surplus that was put into a tax stabilization fund and by readjusting the projected increase in costs of salaries and benefits to reflect a more likely increase of \$116 million (double last year's increase).

The combination of these factors and actions will bring the budgetary shortfall for 2012 down to \$41 million, less than the cost to the city of the mayor's decision to cancel the Personal Vehicle Tax. In other words, the fiscal crisis the City of Toronto is facing is more manufactured than real. The only fiscal crisis facing the city this year is the modestly painful, and preventable, need to make up for the loss of revenue resulting from the mayor's decision to cancel an important source of city revenue.

# Countdown to Zero: Balancing Toronto's Budget

Toronto city council will be making decisions over the next few weeks that will have an impact on our city's future. These decisions will have an impact on our economic future, on the kind of city we live in and on the health of all Toronto residents.<sup>1</sup> As this report makes clear, the City of Toronto is not in a severe financial crisis and without options, as the rhetoric coming from the mayor's office would have us believe. Rather, city council has real choices before it. It can make choices that will support a city building budget: one that builds a more equitable, more prosperous and healthier city for us all. Or, it can make choices that will diminish the city and those who live in it.

By law, the city has to balance its operating budget every year.<sup>2</sup> The budget process is complicated and misunderstood; this is how it works. At the start of the budgeting process, city staff prepare estimates of the *following* year's expenditures and compare them to the *current* year's revenues. These estimates include expected increases in expenditures, but not expected increases in revenues (even those that do not require any explicit decision by city council, such as the automatic increase in revenue from growth in the municipal property tax assessment, or growth in land transfer tax revenues). The difference between these two figures is often called the "opening pressure" or "budgetary shortfall." The city's budget-making process then involves a series of steps to close that budgetary shortfall. In addition to incorporating automatic increases in revenues, the process can also include cost-cutting measures and other revenue increases which require city council decisions (such as increases in property tax rates).

Three factors generally cause this budgetary shortfall to shrink as the budgeting process works its way through city council. First, because of the legislated requirement to balance its operating budget, the city has to be careful to budget for unexpected events (for example, the impact that blizzards can have on the snow clearing budget). Since by definition these unexpected events usually do not occur, the city almost always declares a year-end budgetary surplus that represents, in large part, this unused contingency room. Second, the city is also cautious in estimating how much revenue it will collect. Finally, the budgetary shortfall is measured by comparing the current year's revenues to next year's expenses. Over the course of the budgeting process, unused funds from the previous year become available and estimates for the following year's revenues are updated.

The budgetary shortfall identified by city officials at the outset of each year's budgeting process

is explicitly not a deficit, or even an anticipated deficit. It simply represents the amount of ground that must be covered through the budgeting process in order to ensure that the city's budget is eventually balanced.

Of course, no one would say that balancing Toronto's books is an easy job. The city faces a yawning infrastructure deficit, a growing need for services and a narrow tax base. Federal and provincial governments are not doing their share to support Toronto, whose economy is the sixth largest in the country and one of Canada's crucial economic engines.<sup>3</sup> The city needs a more diversified tax base to support the economic, cultural and social infrastructure needed for such a complex, and diverse city — changing the municipal tax structure is key to resolving its fiscal woes.<sup>4</sup> But, despite these woes, each year city councillors find a way to balance the budget. They have to, by law. It isn't always pretty, and we might not agree with every decision they make, but they manage to do so without draconian spending cuts and without selling off the city's assets.

And, city councillors can do it again this year.

This backgrounder explains how. It compares this year's budget parameters (including the budgetary shortfall) to previous years. It also quantifies how much Mayor Rob Ford's haste to cut taxes and freeze property tax rates contributed to the 2012 projected shortfall. Finally, it shows how doing the same kinds of things that city council has done in the past, can indeed balance the 2012 budget, with no need for drastic measures to address a fiscal crisis that is more manufactured than real.

#### **WHEN IS \$774 MILLION NOT \$774 MILLION?**

In February, the starting point for this year's budgeting process was an estimate of the budgetary shortfall (prepared by city staff) of \$774 million. As explained above, that budgetary shortfall consists of an estimate of 2012 expenses (including normal annual increases) compared to 2011 revenues (excluding any revenue increases, even those that occur automatically). Since that time, as part of the normal budgetary process, a number of adjustments have been made to reduce that number. By late February 2011, city documents were estimating that the shortfall would be \$530 million rather than \$774 million.<sup>5</sup> The number has continued to shift as we move through the fiscal year.

As recently as mid-October, however, Mayor Rob Ford was still publicly stating that the city is facing a \$774 million deficit.<sup>6</sup> The mayor was elected on a platform that promised to find the cost saving necessary to balance the budget without any service cuts by "stopping the gravy train."<sup>7</sup> Since his election, he has directed city departments to cut their budgets by 10 percent and has had the city embark on a service review program. In the core services review, KPMG found that 90 percent of the city's current services are "core" (legally mandated or essential), and another 8 percent are "traditional" (such as Parks & Recreation, which is not legally mandated but which most Torontonians would consider essential). Only 1-2 percent of existing services were found to be outside those two definitions.<sup>8</sup> For all intents and purposes, the KPMG review confirmed that almost everything the city does is essential. Further, the core service review benchmarking exercise found that the city's cost performance compared to other jurisdictions was comparable.<sup>9</sup> While the core services review process did not find the "gravy," the mayor is relying on his direction to city departments and agencies to make across-the-board spending cuts.<sup>10</sup> Though the mayor repeats the \$774 million figure, that does not make it accurate. It seems likely that the mayor's insistence on citing that figure is an attempt to justify cuts to the programs and services that benefit Torontonians.

#### **MAYOR ROB FORD'S CONTRIBUTION TO THE DEFICIT**

The actions of the current city administration have worsened the fiscal challenges facing Toronto. Despite a broad consensus among municipal experts that the city needs a more diversified tax base,<sup>11</sup> Mayor Ford reduced and narrowed the fiscal capacity of the city by cancelling the Personal Vehicle Tax. At an annual cost of \$64 million, it was a very expensive promise to have made.<sup>12</sup> It also creates added pressure to make up the fiscal difference by raising property taxes.

**TABLE 1 — OPENING BUDGETARY SHORTFALL AND STRATEGIES: 2007-2011 (\$ MILLIONS)**

	2007	2008	2009	2010	2011	Average 2007-2011
<b>Opening budgetary shortfall</b>	-562	-615	-679	-821	-706	-677
<b>Increased revenues</b>						
Property taxes	-89	-101	-123	-96	-45	-91
Other taxes + user fees		-175	-6.6	-74	-50	-61
Other revenues				-22	-145	-33
Provincial uploading	-71	-39		-119	-63	-58
<b>Cost cutting measures</b>	-89	-73	-102	-167	-57	-98
<b>One time measures</b>						
One time transfers		-149	-238			-77
Reserve	-76	0	-43	-67	0	-37
Prior year surplus	-131	-78	-74	-276	-346	-181
Other	-106		-92			-40
<b>Total offsetting measures</b>	-562	-615	-679	-821	-706	-677

Source: City of Toronto Budget Committee. *Recommended Operating Budgets 2007-2011*

Unlike income or sales taxes, property tax revenues do not grow at the same rate as the economy. Because income tax and sales tax bases are a nominal economic flow, they automatically generate increased revenues to government with each year of economic growth — without any explicit decision required to “increase” taxes.<sup>13</sup> Income and sales tax revenues tend to automatically keep up with both real economic growth and inflation. That is not the case with property taxes. The nominal rate is set with respect to an assessment base that does not automatically expand with economic growth or inflation. Further, legislation prohibits property reassessment from increasing revenues to the city.<sup>14</sup> Just to keep up with inflation, let alone economic and population growth, property taxes have to be increased each year.

That means the city’s revenues fall short of the actual cost of delivering public services if politicians don’t increase tax rates. Mayor Ford’s decision to freeze property rates for 2011, rather than increase them at a normal rate,<sup>15</sup> cost the city \$68 million this year, and even more in subsequent years (until such time as taxes are increased faster-than-normal to make up for the ongoing effects of the freeze). In total, Mayor Ford’s own actions have so far contributed to \$132 million of Toronto’s 2012 budget

shortfall. The mayor’s actions are inconsistent with a goal of fiscal sustainability.

**COMPARING THIS YEAR’S BUDGET PROCESS TO PREVIOUS YEARS**

Table 1 below shows the annual budgetary pressures that the city has faced over the previous five years, from 2007 to 2011. The estimated opening pressure has exceeded half a billion dollars each and every year. This “shortfall” ranged from a low of \$562 million in 2007 to a high of \$821 million in 2010. In each of those years, city council balanced the budget without resorting to the drastic measures Mayor Ford is proposing this year. Council did so through a combination of cost cutting measures, increased revenues and transfers from other levels of government.

If the “budgetary shortfall” is mistakenly interpreted as a measure of “next year’s deficit,” then the fiscal crisis in 2010 was worse than the crisis in 2012. Yet the budget was balanced in 2010, as surely as it was in every other year, to meet the city’s legal obligation.

**CITY COUNCIL DOES HAVE OPTIONS**

Table 2 below illustrates how city council could get the opening pressure down to zero, by following the same process it has in the past, without relying on transfers from other levels of government, draconian spending cuts, or the sell-off of valuable assets. This is how it could happen:

**TABLE 2 — GETTING TO ZERO (\$ MILLIONS)**

<b>Opening budgetary shortfall</b>	774
<b>Adjustment to salary and benefit cost increases<sup>5</sup></b>	-100
<b>Prior year surplus<sup>2</sup></b>	-181
<b>TTC fare increase<sup>1</sup></b>	-30
<b>Tax stabilization fund<sup>3</sup></b>	-88
<b>Property tax increase<sup>4</sup></b>	-136
<b>Assessment growth<sup>1</sup></b>	-30
<b>MLTT growth<sup>1</sup></b>	-25
<b>Other revenues<sup>1</sup></b>	-46
<b>Cost reductions<sup>2</sup></b>	-98
	-733

Sources:

1. City of Toronto Budget Committee. *2012 Outlook and Long Term Financial Plan Update*
2. This is an average of the previous five years, 2007-2011
3. City of Toronto Budget Committee. *Operating Variance Report for the Year Ended December 31, 2010*
4. Six percent increase: author’s calculations and City of Toronto Budget Committee. *2012 Outlook and Long Term Financial Plan Update*
5. Reduction of salary and benefit cost increases to 2 times the previous year, author’s calculations and City of Toronto. *2011 Budget Committee Recommended Tax Levy Operating Budget*

The TTC fare increase (\$30 million), assessment growth (\$30 million), Municipal Land Transfer Tax revenues (\$25 million) and growth in other revenues (\$46 million) will bring the budgetary shortfall down by \$131 million.

The mid-year estimate of the surplus from 2011 is \$139 million. Over the last five years, the surplus has averaged \$181 million. Assuming the prior year surplus is equal to that average, it could be applied to next year's budget.

As discussed above, nominal property tax rates (unlike sales or income tax rates) must be increased each year just to keep up with inflation and economic growth. A "normal" annual increase in property tax rates could be considered to be around 3 percent.<sup>16</sup> Last year's property tax rate freeze cost the city dearly, and must now be offset with measures to "catch up" revenues. If the tax rate is increased by 6 percent (reflecting two years' normal increases), that would increase revenues by \$136 million.

City council put a portion of the 2010 surplus in a tax stabilization fund; that \$88 million could be applied to the operating budget shortfall.

For the past five years, the city successfully found cost reductions and efficiencies that averaged \$98 million. If the city matches that average, it would bring costs down by \$98 million.

Finally, in 2011, the costs of salaries and benefits increased by \$60 million. This year's increases for Cost of Living Adjustment (COLA), progression pay, and fringe benefit liability contributions are \$216 million. It is reasonable to expect that these costs will not more than triple from one year to the next. If these costs are projected to approximately double, increasing by \$116 million, that would shave another \$100 million off the budgetary shortfall.

The combination of these factors brings the budgetary shortfall down to \$41 million. That \$41 million is less than the annual amount of money Mayor Rob Ford gave up when he cancelled the Personal Vehicle Tax. In other words, the only fiscal "crisis" facing the City of Toronto this year is the modestly painful, but preventable, need to make up for the loss of revenue resulting from the mayor's decision to cancel an important source of city revenue.

## **CONCLUSION**

This report shows that the challenges facing city council are not new. Each year councillors face a similar budget shortfall. Each year councillors balance the budget without gutting public services or selling off valuable city assets. Getting to zero doesn't require hasty or short-sighted actions. We have shown just one of the many paths available to councillors. They have choices. Councillors can make choices that will support a city building budget: one that builds a more equitable, prosperous and healthy city.

# Endnotes

- 1 The Wellesley Institute's upcoming report *The Real Cost of City Cuts: A Health Equity Impact Assessment* reviews three key budget decisions that will have health impacts for vulnerable populations: reducing child care funding and subsidies; the elimination of the Hardship Fund, which provides medically necessary supplies to people with low income; and limiting the development of affordable housing to completing only what has already been approved and funded. See [www.wellesleyinstitute.com](http://www.wellesleyinstitute.com) for more information.
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- 9 Pennachetti, J. (2011) City of Toronto Budget Forum. Page 54-57. Presentation at Toronto Board of Trade, Toronto, Ontario, Canada.

- 10 CBC News. (2011) “Rob Ford denies his governance hurt Ontario PCs.” Retrieved from: <http://www.cbc.ca/news/canada/toronto/story/2011/10/07/ontario-rob-ford-election-toronto549.html>
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- 12 Toronto City Manager. (2010) Personal Vehicle Tax – Repeal of tax and termination of Collection Agreement. Page 1. City of Toronto. Retrieved from: <http://www.toronto.ca/legdocs/mmis/2011/ex/bgrd/background-file-34156.pdf>
- 13 The only “automatic” increase in property tax revenues is that generated by an increase in the City’s assessment base resulting from net new construction. See, Slack, E. (2005) “Easing the fiscal restraints: New revenue tools in the City of Toronto Act.” Page 6-7. Institute on Municipal Finance and Governance, Munk Centre for International Studies, University of Toronto. Retrieved from: <http://www.rotman.utoronto.ca/iib/ITP0507.pdf>
- 14 City of Toronto. (2011) Property Tax: Frequently Asked Questions. Retrieved from: [http://www.toronto.ca/taxes/property\\_tax/faqs.htm](http://www.toronto.ca/taxes/property_tax/faqs.htm)
- 15 Over the past decade Toronto property tax revenues grew at an annual average rate of just under 3%, mostly due to increases in tax rates. In its budget forecasts, the Toronto Board of Trade also assumes a “normal” 3% annual increase in property taxes in its base-case projections. See, Wilding, C. (2011) City of Toronto Budget Forum. Page 2. Presentation at Toronto Board of Trade, Toronto, Ontario, Canada.
- 16 See footnote 15.