

For Information

DATE: October 7, 2008

SUBJECT: **CAPITAL INVESTMENT PLAN UPDATE - TAX SUPPORTED PROGRAM**

FROM: Norma Trim, Acting Chief Financial Officer

OBJECTIVE

The objective of this report is to provide Council with an update on the overall sustainability of the tax-supported capital program.

REPORT HIGHLIGHTS

- Sixty seven million dollars in one time provincial funding should allow Council to sustain the tax-supported capital program without increasing reserve contributions beyond the increase proposed during the 2008 Budget of an additional one per cent tax increase in each of the next ten years.
- Analysis assumes that additional relief will be forthcoming from the province to address major maintenance requirements of aging inventory of social housing in Peel and that current increases to construction costs will moderate over the planning horizon.

DISCUSSION**1. Background**

During the 2008 Budget process staff brought forward a report in regards to the sustainability of our longer term capital financing for the tax supported program. In that report staff introduced a portfolio approach to managing the capital financing program. Specifically, it proposed that the primary focus shift to one of managing the capital financing program as a portfolio and not as scores of individual programs. With a portfolio process, reserve adequacy is assessed at a Regional as opposed to individual program level. This allows healthy reserves to offset program areas with weaker reserve levels before overall reserve contribution levels are increased. By applying a regional perspective to reserve analysis, we are able to moderate the overly conservative contingency planning which is incorporated when programs are evaluated in isolation of each other. This provides additional assurance to the public that programs are funding appropriate but not excessive reserve levels.

Based on a portfolio analysis of reserves, the 2008 Budget proposed an annual increase to reserve contributions equivalent to a one percent tax increase in each of the next 10 years. This was expected to provide an additional \$400 million in funding for the tax supported capital program and was recognized to be the first step towards achieving financial sustainability of our non-growth capital program.

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It also recognized that the ultimate management plan to effectively control the cost of the ten year tax supported capital plan must incorporate many tactics. Continued advocacy with the provincial government for a fairer and more equitable distribution of social costs is a mandatory part of the broader plan as is review of other options to manage the broader social housing issues. The Corporate Asset Management initiative once complete should provide more accurate long-term forecasting of infrastructure needs and funding requirements since it will provide both management and staff with an objective view of program proposals to maintain an effective state of good repair for the Region's existing infrastructure.

2. Pressures on Capital Plan**a) Impact of Growing Construction Costs**

As identified in the presentation made on October 2, 2008 to General Committee by the Acting Chief Financial Officer titled, *"Increase in Construction Costs"*, the monitoring and understanding of the construction price environment has been a priority for the Region of Peel. The major costs of construction inputs (such as crude oil, steel and asphalt) have been rapidly escalating. In just the first eight months of 2008, the average price of crude oil, which is a foundation base for many other construction inputs, has increased by an additional 58.3 per cent (as per Table 1, below). The average prices of asphalt and steel during 2008 have also skyrocketed by 66.8 per cent (July 2007 vs. July 2008) and 51.1 per cent respectively.

While the changes in price of other construction materials (such as sand & gravel and ready mix concrete) have not experienced increases to the same extent, they have shown a steady upward trend between 2003 and 2007. Some of the contributing factors to these upward trends are: weakness of the US economy and currency, supply and demand imbalance, geopolitical uncertainties and speculation. It is expected that for these reasons, prices of major construction inputs are likely to remain relatively high over the short - medium term, causing the cost of growth related capital projects to take a similar approach. Therefore, the cost of construction inputs is continuing to be a primary driver behind a massive impact on the costs of growth.

		ENERGY		MAJOR INPUTS		OTHER INPUTS		WAGES
Year	NCPI	Crude Oil	Nat. Gas	Steel	Asphalt	S & G	Rdy. Mix	Wage Rates
2003	3.7%	19.2%	26.7%	10.8%	10.3%	3.3%	0.4%	2.6%
2004	6.6%	33.2%	12.3%	62.0%	-7.7%	3.6%	2.8%	3.1%
2005	5.3%	36.3%	22.9%	13.5%	2.9%	3.4%	3.4%	3.2%
2006	6.0%	16.4%	3.3%	-2.5%	42.2%	14.2%	5.8%	2.6%
2007	7.0%	10.0%	-5.7%	0.2%	12.3%	24.6%	4.7%	0.9%
2008 to date	10.4%	58.3%	43.9%	51.1%	66.8%	n.a	n.a	n.a

n.a - Not yet available

Sources - World Bank; MTO; Statistics Canada.

At the global level factors include geopolitical tensions, weak US currency, economic expansion in China, demand/supply imbalances and reconstruction of the Gulf Coast. Local factors include increased construction opportunities in part due to distribution of federal gas tax money and shortage of skilled labour.

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The global factors are driving significant increase in the price of key inputs such as the price of crude oil, asphalt and steel. Other factors which affect the price of individual capital projects include scope changes arising from environmental assessments and legislative changes.

b) Other Impacts on Capital Plan

Besides the impact from the rising cost of construction inputs, Peel's capital program continues to grow for a number of other reasons:

- i) **Greater Emphasis on Dealing with Traffic Congestion.** Growing citizen frustration with gridlock has resulted in growing emphasis on enhancing the ability of the road network to meet consumer needs.
- ii) **Development Charge Shortfalls.** Under the existing legislation, development charge contributions have been limited to the extent of the average service level achieved over the last ten years. Growth in programs like Long Term Care, paramedics, day care and housing can not be fully met by development charges. As such, the property tax base must absorb any shortfalls.
- iii) **Provincial Downloading.** In addition the government does not provide adequate funding for programs that it is supposedly cost sharing. The Ministry of Health and Long-Term Care and Paramedic Services will not provide any financing support to the Paramedic capital program. As such the tax base must pick up most of the costs of the proposed \$45 million facility master plan. In actual fact, as a result of development charge ten-year service level caps, the property tax program is required to absorb almost 98 per cent of the cost of the plan. If artificial caps were not in place, property tax would likely only have to adsorb a value in the range of 25 per cent.

A more recent "downloading" issue has been the funding of GO Transit. While this program is clearly owned and operated by the government, it continues to insist that the GTA and Hamilton municipalities pay one-third of the growth capital plan, even if development charges cannot raise these funds. Should the provincial government prevail in this matter, property taxes could be called to fund in the order of \$8-12 million annually for what really is a provincial program.
- iv) **Emerging Issues** such as new waste technologies and climate change initiatives.

3. Affordability of 2009 Capital Budget

At the time of the preparation of this report, the 2009 Capital Budget was still under review. The preliminary proposed capital budget for 2009 for tax-supported programs is currently \$331.3 million. After optimizing the portion that is available for funding from development charge revenues and other external sources, the portion that must be funded from tax-supported reserves amounts to approximately \$194.5 million.

Appendix I provides a projection of the amount that will remain in tax supported uncommitted capital reserves at the end of 2009 assuming we increase the net reserve contributions by the equivalent of a one per cent tax increase plus the \$67 million in one time provincial infrastructure funding.

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At this point the 2009 Capital Budget assumes the \$67 million in provincial infrastructure funding will be used to support the paramedics facility plan and two new social housing projects. Discussions are currently underway with the area municipal treasurers to determine if there are higher priority needs for this funding.

As part of the analysis we have estimated that an additional \$40.0 million will be required between September 30, 2008 and December 31, 2009 to fund net in-year budget changes. This is an estimate based on year-to-date experience. It represents the net reduction in reserves related to budget increases related to new and existing projects partially offset by projects completed under-budget.

The projected balance in tax-supported capital reserves is expected to decrease to \$61.7 million by the end of 2009. In arriving at this estimate staff must make a number of assumptions including the value of any major maintenance that may be required with respect to our capital assets over the next 15 months. At the present time the Region is implementing a Corporate Asset Management framework which will provide the organization with much better data to inform decisions on adequate reserve levels in these areas. The estimated remaining balance in tax-supported reserves will be used to help fund future capital requirements.

4. Long Term Capital Sustainability Strategy

At the time of the preparation of this report the 2009 to 2018 capital plan was still under review however the preliminary plan suggests a tax-supported plan in the range of \$2.4 billion. After optimizing the component that is recoverable from development charges and other external sources, such as grants and other municipal recoveries, the net funding requirement is approximately \$1.2 billion.

Appendix II illustrates the net overcommitted balance that will exist in tax supported capital reserves at the end of the ten year plan assuming we increase the net reserve contributions by the equivalent of a one per cent tax increase for each of the next ten years and include the \$67 million in one time provincial infrastructure funding. Current modeling suggests a net borrowing position in the capital program at the end of the ten-year planning period of approximately \$89 million.

Given the long-term time horizon, there are many things which will impact the reliability of this projection including construction input trends, the outcomes of the provincial municipal review, legislative and technological changes, etc.

Please note that no amounts have been incorporated into the projection for in-year reserve impacts beyond 2009. The analysis assumes that the current increases to construction costs will moderate over the planning horizon. We will need to continue to monitor these trends and their corresponding impacts on the capital program.

5. Contingency Liability for Housing Reserves

It should be noted that the assessment of tax supported reserve requirements over both the next year and ten-year horizon have not included the impacts of any shortfalls related to the funding of repairs to the infrastructure of social housing buildings in Peel. This year the province provided \$5.5 million in funding for repairs to Peel's aging social buildings. With increasing recognition of growing social infrastructure deficits it is anticipated that provincial policies to encourage capital investment will continue.

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In the meantime Appendix III outlines the September 30, 2008 balance in this reserve and projects the impact of the proposed 2009 Budget and ten-year plan assuming no additional funding from the province. It will be important to continue our advocacy efforts for additional funding in this area.

6. Working Fund Reserves


The Financial Control By-Law requires us to maintain five to ten per cent of our Total Budgeted Expenditures in working funds to provide adequate reserves to compensate for one-time items, shocks and unforeseen events.

At September 30, 2008, we have \$144.1 million in working funds. Working funds currently are \$24 million over required levels. Given the current economic environment we are not recommending a decrease to working fund reserves at the present time. Working funds may be required in future to help maintain the sustainability of the capital program.

CONCLUSION

The sixty seven million in one time provincial funding should allow Council to sustain the tax-supported capital program without increasing reserve contributions beyond the annual increase equivalent to a one per cent tax increase that was proposed during the 2008 Budget.

The sustainability of the non-growth capital program will continue to be monitored with regular updates being provided to Council.



Norma Trim
Acting Chief Financial Officer

Approved for Submission:



D. Szwarc, Chief Administrative Officer

*For further information regarding this report, please contact
Norma Trim at extension 4258 or via email at norma.trim@peelregion.ca*

Authored By: N.Trim

c. Legislative Services

**Tax Supported Reserve Analysis
Impact of 2009 Capital Budget**

	\$ millions
Balance in Reserves September 30, 2008	535.8
Less: Utility Supported Reserve Balances	-128.9
Less: Specialty Reserves	
Insurance Stabilization	10.9
GO Transit	1.9
WSIB	11.5
Waste Abatement	23.0
Contingent Liability Housing	54.7
PRP Vested Sick Leave	0.7
	-102.7
Less: Working Funds	-144.1
September 30, 2008 Uncommitted Reserves Related to Tax Supported Capital	160.1
Plus: Net Reserve Contributions including additional 1 per cent	69.1
Plus: One Time Provincial Infrastructure Funding	67.0
Tax Supported Funding for 2009 Budget	-194.5
Less: Estimate for In-Year Reserve Impacts	-40.0
Projected Balance in Reserves to Support Tax Supported Capital After 2009	61.7

Appendix II

Tax Supported Reserves Analysis Impact of 2010 – 2018 Capital Program

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\$Millions

Dec 31, 2009 Uncommitted Reserves
Related to Tax Supported Capital

\$61.7

Reserve Contributions, next 9 years

\$621.9

1% Tax increase for 10 years

\$400.0

Subtotal

\$1,083.6

Tax Supported Reserve Requirements
To Fund 10 Year Plan

(\$1,172.8)

Shortfall

(\$89.2)

1% Tax Increase \$400 M	Tax Supported Reserve Requirements (\$1,172.8 M)
Reserve Contributions 9 Years \$621.9 M	
Uncommitted \$61.7 M	

ANALYSIS OF CONTINGENCY RESERVE FOR HOUSING PROVIDERS

Appendix III

	\$ millions
Balance in Contingency Reserve for Housing Providers	54.7
2009 Contribution to Reserves	2.5
Estimated 2009 Funding Requirements	-6.0
Projected Balance at December 31, 2009	51.2 *
Estimated Impacts of Ten-Year Plan	
Balance in Contingency Reserve for Housing Providers	54.7
Estimated Reserve Contributions over 10 years	24.8
Estimated 10 Year Plan Funding Requirements	-142.5
Projected Shortfall at December 31, 2018	-63.0 *

Note: * Assumes no additional funding received from the province

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