Bridging the Chasm: Fixing the City's Finances – Final Recommendations

TORONTO BOARD OF TRADE

VOTETORONTO2010.COM

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Background

In November 2009, the Toronto Board of Trade (the Board) launched its VoteToronto2010.com municipal election platform with the release of the discussion paper *Vote Toronto 2010: Framework for a Better City*. The purpose of the Board's VoteToronto2010.com campaign and platform is to frame the debate and develop solutions to the major issues in the upcoming 2010 municipal election.

VoteToronto2010.com is the latest component of the Board's focus on the global competitiveness and economic development of the entire Toronto region, building on previous work by the Board, such as *From World Class to World Leader: An Action Plan for the Toronto Region* (October 2009) and *Toronto as a Global City: Scorecard on Prosperity* (inaugural report in April 2009 and second edition in March 2010).

The Board is Canada's largest local chamber of commerce. Founded in 1845, we connect 10,000 members and more than 200,000 business professionals and influencers throughout the region. The Board's mission is to advance the success of our members and the entire Toronto region. The Board strives to be a bold and innovative catalyst for strengthening the economic, social and cultural vitality of the Toronto region. The Board is an authoritative advocate for a strong economic climate, exceptional quality of life and global competitiveness in Toronto.

Four key themes were outlined in *Vote Toronto 2010: Framework for a Better City*:

1. Fixing the City's Finances;
2. Growing the City's and the Region's Economy;
3. Promoting Social Cohesion and Equity; and
4. Improving Civic Democracy

Over the course of the VoteToronto2010.com campaign, the Board will be releasing a number of discussion papers and other relevant information to help frame the debate on each of these critical themes. Well in advance of the election, the Board will distil the ideas into a series of recommendations that will help address these issues in a meaningful way that will benefit all Torontonians.

Toronto's municipal elections have generally not centred on economic development. As Toronto recovers from the global recession, the Board believes the 2010 municipal election should be about the economy: without strong economic development, we cannot create the jobs and support the programs or infrastructure we want in a great city.

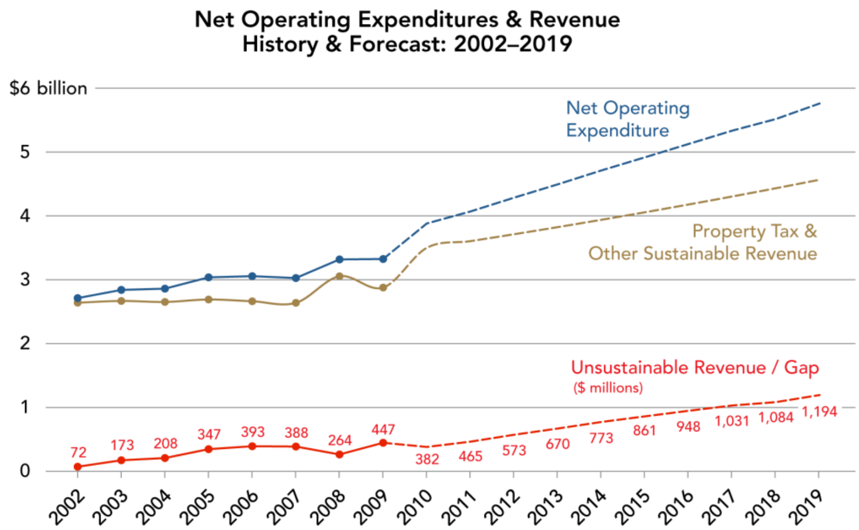
For the theme of Fixing the City's Finances, the Board released *The Growing Chasm: An Analysis and Forecast of the City of Toronto's Finances* (February 2010) and *Taming the (Municipal Budget) Beast: A Survey of How North American Cities are Balancing Their Budgets* (March 2010). Based on a variety of feedback, including extensive consultations with our members, the Board now presents its recommendations for fixing the City's finances.

Our Challenge

The City of Toronto is in a difficult financial situation. There are increasing demands to expand infrastructure and to support vulnerable citizens. But the City struggles each year to make ends meet on its existing commitments, let alone seeking to undertake new obligations.

This difficulty arises because Toronto has a structural operating deficit. This means that Toronto consistently spends more money than it receives and that this deficit position will remain unless actions are taken to make Toronto fiscally sustainable.

In *The Growing Chasm: An Analysis and Forecast of the City of Toronto's Finances*, the Board reviewed the City's finances dating back to 2002 to identify trends in the growth of expenditures and revenues, as well as the primary drivers of each. The Board's analysis found that expenditures were growing by 5.9% a year on average, with personnel expenses – accounting for nearly 50% of expenditures – growing by 6.5% a year on average. At the same time, property taxes (the main source of revenue) were only growing by 2.9% a year on average. Based on these identified trends, and incorporating a number of known incoming sources of revenue (as well as a number of other assumptions about future revenues), the Board forecast the scale of the City's deficit over the next 10 years. The model in *The Growing Chasm* was created prior to the release of the 2010 Operating Budget and does not incorporate information from that budget. Based on this model, without taking actions to address its chronic shortfall, the City's structural deficit will grow to $1.194-billion by 2019.



By law, Toronto, like all Canadian municipalities, cannot run an operating budget deficit, so Toronto has managed to balance its operating budget each year through a variety of measures. But the majority of the measures used to bridge these annual gaps have been one-time fixes: emergency grants from the federal or provincial governments, use of reserve funds and so forth. These measures have enabled the City to get through its budget process each year, but they have also sowed the seeds for the following year's operating budget deficit, which usually grows larger.

For example, the City's 2010 Operating Budget has been balanced as a result of a more than $350-million surplus. However, these surplus funds will not be recurring in future years. So these funds will have to be found through other means in 2011 and beyond. As a result, the City shows that its structural operating deficit will grow from $313-million in 2010 to $469-million in 2011.

Our Goal

By continually struggling to bridge the structural deficit, rather than putting in place a plan to address it, Toronto is unable to move forward. The Board believes that the biggest fiscal issue facing Toronto is not the annual budget crunch, but rather what the City's structural deficit prevents us from doing. Getting the City to a sustainable and balanced operating budget will help to spur jobs, investment and help keep Toronto a great city.

As articulated in *From World-Class to World Leader: An Action Plan for the Toronto Region*, the Board – representing 10,000 members and connecting more than 200,000 business professionals and influencers – has an ambitious vision for the Toronto region. Together, we can achieve this vision. But we cannot do so if we are continually struggling with a structural deficit.

The Board envisions economic growth and job creation throughout the Toronto region through such initiatives as:

- implementation of Metrolinx's regional transportation plan, *The Big Move*;
- properly funded programs and initiatives to address our 13 priority neighbourhoods;
- the creation and expansion of programs to more effectively integrate foreign trained professionals into our economy; as well as
- a stable and attractive business environment that helps to attract investment and create jobs, spurring the economic growth and expansion of the Toronto region.

But we cannot undertake these ambitions if we are continuing to grapple with our past pursuits as a result of a structural deficit.

The Board's Recommendations

There is no single silver bullet that will get Toronto back on the path to fiscal sustainability. Just as there are many factors that have created the structural deficit, there are many ways to reduce and eliminate it.

It won't be easy. But it can and must be done.

And it can be done without significant reductions or cuts to service levels or significantly increasing property tax rates.

In fact, addressing Toronto's structural deficit can help lead to expanded services, such as public transit, that are key to keeping Toronto a great city.

And showing accountability by producing a plan to return the City to a fiscally sustainable position will strengthen the City's ability to negotiate further cost-sharing arrangements with senior orders of government, such as for TTC operating expenses.

To tackle Toronto's structural deficit, the Board offers a number of recommendations. These recommendations include three measures that must be adopted by the next mayor and a number of other initiatives that can also be used to solve the budget crunch.

The "must do" recommendations will significantly reduce, and go a long way toward eliminating, Toronto's structural deficit. The additional recommendations can be used to get us the rest of way.

These recommendations reflect new and long-standing positions of the Board of Trade; many have also been put forward by other stakeholders, such as the Mayor's Independent Fiscal Review Panel.

The 3 "Must Dos"

Implementing these recommendations will cumulatively save the City **at least $2.2-billion** over the next 5 years. These quantified savings do not include economies that will be achieved by reducing the City's debt (with debt service charges of about $450-million a year), as fully accounting for this impact would require presuming which assets will be targeted and the net value that can be extracted from them.

1. **Reform the labour model.** Representing almost half of all expenditures, fiscal sustainability cannot be attained without addressing this part of the budget. The Board believes that a short-term transition needs to take place while the City establishes a strong, long-term and sustainable human resources development plan. The Board sees four key areas for reform:

- *Targets to reduce corporate labour costs:* Set out savings targets for managers to achieve related to their personnel costs, to be reinforced by a hiring freeze for at least this year and to possibly stay in place for the remainder of the current collective agreement.
  At present, the City has a 6% attrition rate that is likely to increase as baby boomers retire.

Utilizing this attrition, the Board believes a **savings target of at least $265-million** should be achievable within 2 years. Achieving this target would require leveraging (and thus not replacing) approximately half of the attrition that takes place during these two years. Hiring that would be needed to reach preferred staffing levels should be limited until a new labour model or collective agreement is in place. To provide managers incentives to find these savings, they should be allowed to retain a percentage of the savings they find. The savings in labour costs should be pursued over the course of the current municipal workers' agreement and should inform the next round of negotiations.

- *Program savings targets:* It should be possible to reduce the cost of delivering services. Many of these savings can be achieved through a change in the service delivery model and/or containing the annual increase in costs. Most of these savings cannot be achieved, though, until current contracts expire.

  In-house waste collection in Toronto is currently twice the cost per tonne of other GTA regional municipalities' contracted waste collection services. Bringing this down to only 125% of the GTA average would cumulatively save the City **almost $104-million in 2014 and 2015** (the first two years of a new collective agreement for City staff).

  Keeping the average increase in costs of Police Services to only 3% per year (rather than the current 6%) would cumulatively save the City **over $270-million between 2011 and 2015** (this would cover likely the next Police Services contract and the first two years of the contract following that).

  Employing a similar savings target at the TTC as for the rest of the municipal workers – leveraging attrition of 4% over 2 years (which should be occurring as greater automation, such as the implementation of the PRESTO regional integrated payment system, takes place throughout the system) and keeping the average increase in costs to only 3% (rather than the current 6%) would cumulatively save the City about **$250-million between 2011 and 2015** (this would cover likely the next TTC workers' contract and about the first two years of the contract following that).

- *Allow competitive bidding for the delivery of services:* Service delivery (particularly for services like waste collection, road repairs and parks and recreation) should be opened to all qualified bidders, including bids from unions either in Toronto or elsewhere. It is critical that requests for bids are structured in a way that does not favour any particular class of bidders. In Indianapolis, this policy resulted in a savings of $230-million over 5 years. Similar economies in Toronto would save the City **$46-million a year**.

- *Reform the City's pension plan.* City employees enjoy retirement benefits that few taxpayers enjoy. The City's unfunded liability stood at $2.59-billion in 2008 – and will have to be paid for by future taxpayers. The inequality of asking taxpayers to fund benefits much more generous than they themselves enjoy was recognized in the 2009 municipal workers' strike, where the City capped and will phase out over time the accumulated sick leave benefit. It is time to do the same with defined-benefit pensions. Governments around the globe are now reforming this public sector benefit; Toronto should be among them. The City should start a dialogue with the various unions in order to reach consensus on this issue to be implemented in the next collective agreement. Implementing a hiring freeze and reducing the workforce through attrition, as recommended above, will settle the City's future unfunded liability and ensure it does not continue to grow. At present, the City needs to spend over $200-million each year to cover these benefit costs. Significant pension reform is needed to stabilize, and gradually reduce, this line item.

2. **Reduce/Eliminate debt to enable infrastructure investment.** The City of Toronto currently pays about $450-million each year to service its debt (interest and principal). At an average annual increase of 14.6% between 2002 and 2008, this particular expense is growing faster than any other incurred by the City. And because of the City's current debt level, there is no ability to invest in the infrastructure expansion needed in a great city. The City still has a $490-million promissory note from Toronto Hydro it could cash in to **save over $55-million net in debt service charges over the next three years**. Further, extracting value from certain City assets such as Enwave, Toronto Parking Authority, Toronto Hydro and Metro Hall – a task currently assigned to Build Toronto for under-used real estate holdings – could help us build Toronto for future generations. It is critical that the funds generated from such transactions are used to pay off debt or go into capital reserves and not to plug an operating budget deficit.

3. **Introduce multi-year operating budgets.** Planning for both the short- and the long-term is a critical step toward achieving fiscal sustainability. Plus, focusing on more than just the current fiscal year's budget is needed to change the corporate culture of the City. With budgeting being done only one year at a time, as at present, the longer-term fiscal implications of particular actions tend not to be considered and accountability as a whole suffers. The Board and the Mayor's Independent Fiscal Review Panel have recommended the introduction of rolling 5-year operating budgets to complement the current 10-year capital budgets.

Additional Budget Savings Options

- Identify annual efficiency savings targets. The multi-year budgets will need to identify targets for efficiencies to be achieved in each of the years going forward.

- Streamline the budget process. Rather than the current "bottom-up" approach to budgeting, the City's CFO should be empowered with greater control over the operating budget through a "top-down" approach to budgeting that will also provide greater oversight of the 119 agencies, boards, commissions and corporations (ABCCs).

- Continue core services and initiate a cost optimization review. These reviews should be conducted in a public and transparent manner. From this review, identify where there is duplication or overlapping responsibilities and determine if there are programs or services from which the City should exit.

- Create greater coordination, cooperation and cost sharing between the City and the ABCCs. The ABCCs account for almost 30% of the City's budget, but the City has little influence over their operations or budgets. This lack of influence contributes to the City's corporate culture where accountability and long-term fiscal implications are not a primary focus. Council should set goals and targets for the ABCCs and the CFO should be an active participant in their budgeting process. Significant cost savings can be attained from the sharing of resources and best practices. The ABCCs should be included in any City-wide review or consolidation of assets, responsibilities and/or services (as recommended above).

- Reform the City's procurement model (through which the City purchases over $1-billion annually). As shown in a study by the Residential and Civil Construction Alliance of Ontario, Toronto and other municipalities overpay for contracted goods and services because of their procurement process. Experts suggest as much as 20% savings annually can be extracted. Improving this process should produce a savings for the City of**at least 10% of procured purchases or at least $100-million each year.**

- Consolidate certain key shared functions and responsibilities. Such a consolidation has already taken place in the provincial government (Ontario Shared Services), has been recommended as a cost saving measure to Canadian municipalities (such as Vancouver) and has been instituted by major multinational corporations. Key services to consolidate include financial transactional processing and collections, supply chain management, payroll management, processing and benefits administration, as well as enterprise business support solutions. Ontario Shared Services has **realized a reduction in the number of staff providing these services of approximately 25%, as well as an almost 9% reduction in its budget (representing about $16-million)** for the services it covers between 2004-05 and 2008-09.

- Institute a "Catch the Little Things" program. This program is also key to effecting a change in the corporate culture and would ensure that cost overruns do not occur on such things as travel expenses, absenteeism, entertainment and overtime expenses. Since 2005, audits by the Auditor General have found an estimated $87-million for the City, or **approximately $17-million a year**. Such a program must be implemented with a minimal cost structure.

- Introduce competition in the delivery of TTC operations. This would involve the TTC contracting with a private company to provide transit services for certain routes or in certain regions. The transit system can specify service levels and parameters in the contract, which would also form the basis of the contractors' level of compensation. It is not the privatization of the TTC.

  The operations of GO Transit and York Region's VIVA service are currently contracted out. In fact, the TTC has contracted with York Region to operate some of their bus routes.

  Transit systems around the world have also pursued this option. When Stockholm pursued this course of action in the 1990s, their **operating costs declined by 25%, while service levels went up 10% and ridership increased 15%.**

- Close out long-term vacant positions. Competitions for positions that have been posted for six months or longer, but have still not been filled by an appropriate candidate should be closed. This tactic has been employed recently in a number of Canadian municipalities, such as Ottawa and Calgary. To keep a position from being closed out would require a written explanation to and approval from the City Manager.

- Allow the redeployment of City workers into vacant positions. This policy is beneficial for both City employees and for taxpayers, as it will help contain costs by eliminating the need to hire new City workers when an existing employee can move into the position and it will increase the skill level of City workers by offering them training to properly execute in their new position.

The Roads Not Taken

As mentioned above, the Board believes the City's structural deficit can be reduced and ultimately eliminated by pursuing some transformational changes.

These changes will not require significant reductions or cuts to service levels or significantly increasing property tax rates.

Below are some measures that are being pursued in other North American cities to deal with their respective budget crunches. The Board considered these measures, but is not recommending them at this time. The Board does not believe such measures are necessary if action is taken by the next administration to put the City back on a fiscally sustainable path.

- Double-digit property tax increases (as was highlighted in the City's updated long-term fiscal plan as being necessary to balance the budget if the status quo is maintained)
- Employee lay-offs (as was done in Chicago, Philadelphia, Atlanta, Los Angeles, Boston, Vancouver, Calgary and Montreal)
- Furlough or government "slow down" days (as was done in Chicago, Philadelphia, Atlanta and Los Angeles)
- Elimination of pay increases (as was done in Chicago, Philadelphia and Los Angeles)
- Privatization of child-care and other social services – City acts solely as regulator, rather than both regulator and provider (as was done in Windsor)
- Elimination of certain types of waste collection (as was done in Philadelphia)
- Closing down recreational facilities (as was done in Atlanta, Phoenix and Vancouver)
- Having employees cover more of the cost of/reductions in the level of their benefits (as was done in New York, Chicago, Philadelphia and Atlanta)
- Reduced funding and hours of operation for public libraries (as was done in New York, Philadelphia, Phoenix, Los Angeles, Boston, Vancouver and Ottawa)