White Papers on the Financial Sustainability of Local Governments in Eastern Ontario

Produced by the
Eastern Ontario Wardens’ Caucus
LETTER FROM THE CHAIR

EXECUTIVE SUMMARY

MUNICIPAL INFRASTRUCTURE

CHAPTER 1

MUNICIPAL AFFORDABILITY

CHAPTER 2

RATEPAYER AFFORDABILITY

CHAPTER 3

ENVIRONMENTAL SERVICES

CHAPTER 4

SOCIAL HOUSING

CHAPTER 5
July 31, 2014

It is with great pride and pleasure that the Eastern Ontario Wardens’ Caucus presents its partners in the municipal, provincial and federal sectors with the conclusion of its extensive research into the financial sustainability of local governments across rural Eastern Ontario.

Over the past two years, following the release of a landmark analysis titled “Facing our Fiscal Challenges: A Report on the Financial Sustainability of Local Government in Eastern Ontario,” the EOWC researched and developed a series of White Papers to explore further prospects for financial sustainability through to 2020.

These five EOWC White Papers confirm, among other things, that rural ratepayers across the region are increasingly challenged to pay the costs of vital municipal services. Rural Eastern Ontario ratepayers, like local governments, are at a crossroads in terms of financial sustainability. Residents simply can no longer afford to pay the ever-increasing costs of municipal services, particularly when rural areas have increasing amounts of infrastructure to be maintained by a relatively small and widely-dispersed population.

In presenting these White Papers as a whole document, the EOWC is looking to continue the efforts that have previously been explored with its partners and which have largely proven to be successful. As financial circumstances and budgets continue to be tightened, rural municipal governments will require more active support in stimulating growth and employment and, in turn, the regional tax base. At the same time, provincial and federal partners must continue their efforts to contain the growth in costs for service delivery.

The EOWC will continue to advocate on behalf of its 103 member municipalities across rural Eastern Ontario and work diligently to contain costs and generate revenues. It should be noted that these White Papers surpass the EOWC’s omnibus study by offering both projections and recommendations to improve the financial circumstances of our residents; however, upper levels of government must continue to partner with municipalities in order to develop and implement new approaches to lighten the burden for ratepayers.

In other words, while some of the outlined recommendations refer to initiatives that the EOWC can undertake on its own, others are likely to be most successful if pursued in partnership. Let us collectively move forward, in the best interests of all our residents.

Jean Paul St. Pierre
Chair, 2014, Eastern Ontario Wardens’ Caucus
Eastern Ontario Financial Sustainability Update Project

Executive Summary as at July 31, 2014

Following the release of the landmark analysis of the sustainability of 103 local governments in Rural Eastern Ontario in February of 2012, the Eastern Ontario Wardens Caucus (EOWC) developed five White Papers to explore further prospects for financial sustainability through to 2020. Each White Paper updated financial data to 2012 (based on provincial Financial Information Returns/FIRs), added extrapolated projections through to 2020, and offered recommendations to address the challenges ahead. The recommendations are directed to the EOWC member municipalities, provincial and federal governments. Among the more than 50 recommendations contained in the five White Papers are two cornerstone recommendations, implementation of which will have positive impacts – either directly or indirectly – across all areas of service:

- Active support and implementation of a regional economic development strategy with the long-term objective of stimulating growth as well as jobs across the region, which will in turn stimulate growth in the region’s tax base.
- Encouragement for the province’s efforts to contain the growth in costs for service delivery.

Municipal Infrastructure (August 2013): Municipalities in Rural Eastern Ontario manage nearly $9 billion in assets, $5 billion of which is for transportation services (roads and bridges). The capital infrastructure deficit is estimated at $3.74 billion (2011) with $3 billion for roads and bridges. Rural municipalities are responsible for 75% of the region’s roads (69,000 lane-kilometres) and 5,000 bridges and large culverts. The associated capital infrastructure deficit is $2.48 billion for roads and $526 million for bridges. Municipalities should be making an additional $638 million a year in capital expenditures to maintain their assets. The White Paper notes that none of the three financing mechanisms for addressing infrastructure needs (debt, direct from property taxes, utilization of reserves) is sustainable. Both debt capacity and reserves would be exhausted in two years. The White Paper contains six recommendations, including the creation of a permanent provincial non-competitive infrastructure fund, with a suggested design framework and allocation methodology.

Municipal Affordability (August 2013): Local governments in Rural Eastern Ontario have significant responsibilities in delivery of (largely) provincially-mandated services to their citizens: annual operating expenditures are now roughly $2 billion a year. Expenditures for four major service areas (Transportation Services, Protection Services, Environmental Services, and Health and Emergency Services) all increased by 7% a year or more in the 2000-2011 period – well above the rate of population/household growth (1% a year) or the Consumer Price Index (2% a year). As a result, Own Purpose Revenues (property taxes and user fees/charges have increased by a Compound Annual Growth Rate of 6.1% since 2000) in a region where three-quarters of municipalities have median household incomes below the provincial average. Real assessment growth in rural areas is weak (2% a year or less), especially in the commercial and industrial sectors, and local governments are therefore heavily reliant on residential property taxes (2012: 90% of total taxes compared to 84% for the region as a whole). Development prospects for the region are also constrained by the 75% of land mass that is not available for full assessment value taxation. Without a change in the economic circumstances of Rural Eastern Ontario, continued above-CPI increases in property taxes are not sustainable. The White Paper contains 13 recommendations, focused on cost containment, alternative revenue generation, and exploration of new methods, models and funding formulae for delivering municipal services.
Ratepayer Affordability (December 2013): This White Paper notes that citizens of Rural Eastern Ontario are financially disadvantaged, as compared to the provincial average, on virtually every measure: lower average and personal median incomes and household incomes, lower reliance on employment income and higher reliance on government transfers (15.4% compared to 12.3%). Population and household growth projections for the region are modest with the proportion of elderly citizens well above the provincial average (18% compared to 15%). Levels of home ownership are high but the value of those dwellings is lower and a higher proportion of the homes are in need of major repair (8.2% compared to 6.6%). Rural Eastern Ontario residents are also less likely to have post-secondary education (47% compared to 57%) so their employment and earnings prospects are more limited. Nine recommendations focus on ways to enhance the region’s labour force and access to employment, new strategies targeted to specific sub-populations (e.g. SMEs, youth), and housing-related initiatives.

Environmental Services (June 2014): Local governments in the region are responsible for more than $2 billion in assets (2012) with more than $225 million in annual operating expenditures (63% of expenditures are for water, wastewater and sewer services). The Compound Annual Growth Rate in operating expenditures was 5.9% in the 2000-2012 period. The rural areas are responsible for nearly 500 landfills (90% of the regional total), with net/unfunded liabilities estimated at $100 million (not including new landfills). Net cost per tonne for material diverted from landfills is higher in rural areas compared to urban areas due to smaller volumes and larger geographic areas for collection. Eight recommendations encourage cost containment by collaborative administration and management, exploration of new environmental technologies, repurposing of legacy assets, cost-benefit analysis and provincial funding for any new environmental regulations or upgrading existing compliant assets.

Social Housing (June 2014): Across Eastern Ontario (excluding Ottawa), municipalities are directly responsible for $467 million in social housing assets. Because of the age of many of these units as well as variations in assigning value, the capital infrastructure deficit is likely to be at least $526 million. Including municipal social housing units and those offered by not-for-profit organizations or private sector organizations (Rent-Geared-To-Income), there are an estimated 14,000 housing units in the region. Comparison of the region’s End of Agreement situation (wind-down of federal funding for social housing) to that of the province as a whole suggests that more than three-quarters of the region’s social housing projects – at least 10,000 units – will not be viable at EOA (either due to insufficient investment capital, insufficient revenues to cover operating expenditures, or both). Waiting lists for social housing are relatively stable (in the 7,500 to 9,000 households range) but there is a need for a transitional strategy for social housing to match the locations and configurations of housing units with citizens’ contemporary needs. The Paper notes that social housing is not sustainable without support from upper levels of government. Eleven recommendations call for shared effort by the province’s stakeholders to encourage the federal government to remain financially supportive of social housing. The provincial government is asked to update operating subsidies to reflect contemporary costs, provide low/no-interest loans, and strategic policy latitude to enable municipalities to transform the portfolios of social housing stock to meet changing local needs. On a local level, the White Paper suggests exploration of different business models to increase efficiency of maintenance of social housing stock.
Municipal Infrastructure

One of a Series of White Papers

on the

Financial Sustainability of Local Governments in Eastern Ontario

Produced by

The Eastern Ontario Wardens’ Caucus

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Table of Contents

1. Executive Summary........................................................................................................ 2
2. Introduction..................................................................................................................... 8
3. Municipalities in Rural Eastern Ontario Manage Nearly $9 Billion in Assets................. 9
4. Eastern Ontario: A Pattern of Highly Variable Capital Investment......................... 10
   4.1 Total Capital Investments Over the 2000-2011 Period........................................... 10
   4.2 Projecting Expenditure Patterns and Financial Requirements....................... 10
   4.3 Annual Capital Expenditures – Transportation Services................................... 11
5. Municipal Capital Spending Not Keeping Up to Needs.............................................. 14
   5.1 Net Book Value of Capital Assets Continues to Decline...................................... 14
   5.2 Municipal Assets Per Household........................................................................... 15
6. Capital Infrastructure Deficit Now Stands at $3.74 Billion..................................... 16
   6.1 Capital Infrastructure Deficit Continues to Grow.............................................. 16
   6.2 $374 Million a Year Required To Address Deficit Over Next 10 Years.............. 16
   6.3 $700 Million a Year Required to Maintain Entire Asset Pool........................... 17
   6.4 Combined Capital Investment Needs at $1.08 Billion Starting Now.................. 18
7. Three Ways for Municipalities to Finance Infrastructure Investments.................... 19
   7.1 Ways to Finance Infrastructure Investments....................................................... 19
   7.2 Property Taxpayer Contributions Reach A Billion a Year................................... 20
   7.3 Municipalities Face Increasing Pressure to Take on Debt............................... 21
   7.4 Environmental Services Investments Are Significant Share of Debt............... 22
   7.5 Rural Municipalities Using Half of Debt Capacity........................................... 24
   7.6 Debt Service Costs Could Crowd Out Other Operating Expenditures.............. 25
   7.7 Debt Servicing Costs Rising as Percentage of Total Operating Revenue........... 27
8. Maintaining or Growing Reserves Will be Difficult in Years Ahead........................ 27
   8.1 Rural Eastern Ontario Had $686 Million in Reserves at End of 2011................. 27
   8.2 Rural Eastern Ontario May Have $845 Million in Reserves by 2020................... 28
9. Taking Action on Municipal Infrastructure................................................................... 29
   Appendix A: Description of Transportation Infrastructure Renewal Enterprise (TIRE) 30
   Appendix B: Recommendations on a Permanent Municipal Infrastructure Fund........ 31
1. Executive Summary

At the end of 2011, the 103 municipalities in Rural Eastern Ontario held **$8.7 billion in capital assets** required to deliver the full range of services for which local governments are mandated. In rural areas, these capital assets range from recreational facilities, roads, bridges and libraries, to homes for the aged, water/waste water systems and fire stations.

Upper/single tier municipalities (counties) are responsible for roughly $3.3 billion of this infrastructure (38% of the total) and lower tier municipalities (townships and small towns) are responsible for $5.4 billion (62% of the total). The types of infrastructure requiring the largest initial investment and the largest financial responsibilities for maintenance are assets for provision of **transportation and environmental services** ($5.06 billion and $1.99 billion respectively, at cost). These two asset categories represent more than 80% of local government assets in Rural Eastern Ontario.

Nearly half ($4.17 billion or 48%) of total investment in Rural Eastern Ontario’s infrastructure has been made since 2000. **Capital investment** over the period averaged **$378 million** a year. Although the pattern of investment has been variable (reflective of both opportunity and availability of municipal funds1), the scale of investment suggests a consistent effort to ensure that local services are offered through safe, well-maintained assets.

In rural areas with a small and widely-dispersed population2, municipal governments face major challenges with both upfront investments and ongoing maintenance – especially when **operating expenditures** for municipal services have reached **$1.8 billion a year**. As a result, the pattern of capital investment across Rural Eastern Ontario has been highly variable – from roughly $200 million in 2000, peaking at just over $610 million in 2010, then dropping back to $388 million the following year. This variability is a signal that municipalities struggle to find the resources to invest in capital assets and plan carefully to be able to make the best use of opportunities for matching funds from other levels of government – in effect making each dollar go further. Clearly, rural municipalities need help from upper levels of government and they need it in predictable amounts and timeframes.

Based on financial data from the end of 2011, one estimate of the region’s capital infrastructure deficit (based on the difference between Capital Cost and Book Value) indicates that municipalities continue to lose ground in their efforts to find and deploy sufficient resources to maintain their infrastructure. By this measure, the **Capital Infrastructure Deficit** now stands at **$3.74 billion** and continues to rise, by roughly $150-$200 million a year.

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1 Rural Eastern Ontario has a population of just over 700,000 people in roughly 360,000 households. Local governments are responsible for services over a geographic area of 45,000 square kilometres. Ten separated cities and towns, plus the City of Ottawa, make up the balance of the 50,000 square kilometre area commonly referred to as Eastern Ontario.

2 Average population density across Rural Eastern Ontario is roughly 16 persons per square kilometre. There are roughly eight (8) households per square kilometre across the region.
To discharge the accumulated capital deficit in ten years would require investments of $374 million a year, plus another $700 million to maintain all municipal assets over the long term. (The annual maintenance estimate is based on an average 25 year asset life and replacement cost at twice the original cost). Taken together these two estimates suggest that municipalities in Rural Eastern Ontario should be investing $1.074 billion a year in their infrastructure every year until at least 2020.

In 2011, municipalities in Rural Eastern Ontario made capital investments of $388 million (very close to the long-term average). Compared to the target ($1.074 billion), this suggests that there is an annual capital investment shortfall of $686 million.
The level of investment called for in this analysis, which represents a near tripling of current capital investment, is beyond the long-term investment pattern of rural municipalities (2000-2011). Even in a scenario calling for rapid ramp-up in investment beyond 2011 levels, it is unlikely that Rural Eastern Ontario would reach required levels of capital investment by the end of the decade. Municipalities would have to spend **an additional $686 million every year** to reach the billion dollar annual investment mark by 2020.

Figure 5 – ES: Total Capital Expenditure Requirements to 2020

Figure 5 (above) shows a baseline projection of anticipated capital expenditures based on the 2007-2011 performance, leading to $436 million in annual capital investment by 2020. The additional required $686 million a year to address the deficit and provide long-term maintenance for all assets is shown as ramping up rapidly through 2012-2017 to reach the required $1.07 billion by 2020. This scenario reflects the challenges municipalities are expected to have finding the required investment funds – especially in the near term – and implies that municipalities will take a slightly longer timeframe to reach the required spending levels.

Like the Province or the Federal Government, municipalities have only **three options for financing services and infrastructure**:

- Property tax revenues and other user fees and charges paid by ratepayers
- Debt which must be repaid out of property tax revenues
- Reserves which can be a short-term contributor to infrastructure financing but this option disappears once reserves are depleted.
**Revenue from Taxation:** In 2011, municipalities in Rural Eastern Ontario took in nearly $1.07 billion in “Own Purpose Revenues” (property tax revenues and other user fees and charges). More than three quarters of these revenues were property taxes and are used to cover operating costs for the many services offered by municipalities as well as servicing debt.

Property taxes increased by 92% since 2000 (a compound annual growth rate of 6.1% – a rate much higher than the Consumer Price Index in the same period). With roughly three-quarters of municipalities in the region exhibiting median household incomes below the provincial average, it is difficult to envisage how municipalities can use the local property tax base to generate the funds necessary to close the infrastructure funding gap.

**Reserves:** These municipalities hold $686 million in reserves (obligatory, discretionary and reserve funds combined). In addition to ongoing capital investments, these funds are used to manage operating and capital cash flows within a fiscal year, to respond to in-year emergencies, and sometimes to provide the municipal match for infrastructure funding.

Municipal reserve levels are only slightly more than combined debt of $556 million and, if fully deployed in a single year, would represent just one year’s requirement for additional capital investment.

*Figure 6 – ES: Overall Financial Position of Local Governments in Rural Eastern Ontario at 2011*
**Debt Financing:** Municipalities in Rural Eastern Ontario have tripled their debt since 2000, with environmental and transportation assets often being financed through debt. Total municipal debt now stands at $556 million.

Municipalities have used about half of their total debt capacity (as calculated using the Ministry of Municipal Affairs and Housing methodology) which means there could be as much as $575 million in debt capacity remaining (roughly 15% of the capital infrastructure deficit). However, the ability to bear more debt varies by municipality and many with major capital infrastructure needs may have little or no debt capacity left.

The additional debt servicing charges associated with further debt financing ($165 million a year) would strain operating budgets and potentially “crowd out” other operating expenditures on programs and services that are mandated, expected and valued by citizens.

For all these reasons, the opportunity to use debt financing to address capital investment needs is limited.

*Rural municipalities have an ongoing revenue challenge, which is particularly acute for capital infrastructure investment.*
Taking Action on Municipal Infrastructure

Affordable municipal infrastructure will require local governments to change the trajectory of the costs and methods associated with infrastructure investment and maintenance as well as the revenues available for infrastructure purposes. The following recommendations cover some actions that local governments might take on their own or through the EOWC, as well as those which might be undertaken in partnership with upper levels of government.

**Recommendations for EOWC and Constituent Municipalities:**

E-1: It is proposed that the EOWC continue to actively support the development and implementation of a regional economic development strategy, with the long-term objective of stimulating growth as well as jobs across the region, which will in turn stimulate growth in the region’s tax base.

E-2: It is proposed that the EOWC create a regional infrastructure task force to explore ways to reduce the need for future infrastructure investments, reduce maintenance costs for existing infrastructure, and manage required infrastructure as efficiently as possible.

E-3: As part of the regional infrastructure task force, it is proposed that the EOWC lead the creation of a transportation infrastructure renewal network comprised of municipalities in Rural Eastern Ontario, to explore (among other topics) possible cost savings through collaborative action (examples: reducing costs through larger tenders and equipment sharing) and greater use of techniques to extend the life of existing assets. *(A description of this network is contained in Appendix A.)*

E-4: It is proposed that all municipalities in Rural Eastern Ontario be encouraged to ensure that their Asset Management Plans are complete by the end of 2013 as required.

**Recommendations for the Province of Ontario:**

U-1: It is proposed that the EOWC work in partnership with the Province of Ontario to design and to implement as soon as possible a permanent, predictable, non-competitive infrastructure fund designed specifically for small, rural and remote areas *(See Appendix B for recommended design parameters.)*

U-2: It is proposed that the Province of Ontario continue implementation of the social services upload to 2018, thereby providing additional fiscal capacity for municipalities to address infrastructure maintenance needs as well as assisting in the provision of other critical municipal services.

U-3: It is proposed that the Province of Ontario provide Eastern Ontario municipalities that have significant Crown lands or other lands with assessment constraints (e.g. managed forests, farmland, aggregate sites etc.) within their jurisdictions with compensation reflecting these property-based limitations. The compensation could be a Payment-in-Lieu or an annual share of revenues accruing to the Province from these lands (e.g. royalties from stumpage fees). This compensation would be in recognition of the service provided by municipalities in building and maintaining roads and bridges, and providing emergency services for these tax-exempt lands.
2. Introduction

Following the completion of the landmark analysis of the overall financial sustainability of local governments in Eastern Ontario in February 2012, the Eastern Ontario Wardens Caucus commissioned several follow-up projects to:

- Examine selected priority areas in greater detail, and
- Update key variables so the work would remain current and could be used with confidence as a support to future EOWC initiatives.

The EOWC identified five priority areas for further attention, each of which is being addressed using a White Paper format:

- **Municipal Affordability** – an examination of operating conditions for municipalities.
- **Ratepayer Affordability** – an examination of the financial circumstances of local economies and the rural residents and organizations who bear most of the cost of municipal service delivery.
- **Municipal Infrastructure** – an examination of the conditions influencing the overall state of municipal infrastructure and municipalities’ ability to invest in and maintain these assets.
- **Social Housing** – an examination of the financial circumstances of upper/single tier municipalities in addressing these community needs, both in terms of local demand for service and the financial implications of associated capital infrastructure requirements.
- **Environmental Services** – an examination of the financial circumstances of single/lower tier municipalities in addressing these responsibilities, on both operating and capital fronts.

The White Papers on Municipal Affordability and Municipal Infrastructure are being released in the late summer of 2013 while the Papers on Ratepayer Affordability, Social Housing and Environmental Services will be released in the fall of 2013.

Each of these White Papers has added two new features not included in the original financial sustainability analysis. First, the White Papers have added financial projections to allow the EOWC and other stakeholders to understand what the financial future holds in the year 2020 if recent trends continue. Second, the White Papers contain recommendations for action to address the challenges foreseen as a result of the projections.

**Methodology:** Projections were made based on simple straight-line extrapolation from the actual experience in three time periods: 2000-2011, 2007-2009 and 2009-2011. Most data is from the annual municipal Financial Information Returns (FIRs).
3. Municipalities in Rural Eastern Ontario Manage Nearly $9 Billion in Infrastructure Assets

At the end of 2011, municipalities in Rural Eastern Ontario held $8.7 billion in capital assets – valued at cost. Upper/single tier municipalities (counties) are responsible for roughly $3.3 billion of this infrastructure (38% of the total) and lower tier municipalities (townships and small towns) are responsible for $5.4 billion (62% of the total).

These capital assets, commonly referred to as municipal infrastructure, cover the full range of services provided by local government and most of these services are mandated by the Province for delivery by municipalities. They are not optional. For municipal governments in Rural Eastern Ontario, these infrastructure assets include:

- **Transportation systems** (such as roads, bridges, sidewalks, lighting fixtures, guardrails, maintenance equipment, sand/salt storage facilities)
- **Health and Long Term Care** assets (such as ambulance services and homes for the aged)
- **Protection Services** (such as fire stations or emergency measures centres)
- **Social housing** (such as affordable housing for those with low incomes, disabilities or other special needs)
- **Environmental services** assets (such as landfills, fleets for waste collection and recycling, water and sewer systems, water distribution systems, storm water systems)
- **Community facilities** for Culture and Recreation (such as community halls, libraries, arenas, theatres and parks)
- **Municipal buildings** (for administrative services).

In Rural Eastern Ontario, the types of infrastructure which require the largest initial investment and the largest maintenance responsibilities tend to be transportation systems and environmental assets, although for smaller municipalities especially, the cost of building/purchasing and maintaining any of these assets can be a heavy burden.
4. Eastern Ontario: A Pattern of Highly Variable Capital Investment

4.1 Total Capital Investments over the 2000-2011 Period

Total Capital Investments by local governments in Eastern Ontario totalled **$4.17 billion since 2000** and have been highly variable over the past decade, rising from $198 million in 2000 to a peak of $613 million in 2010, then dropping to **$388 million** in 2011. This period represents nearly half (48%) of all investment in Rural Eastern Ontario’s infrastructure.

Since 2000, there have been multiple peaks in the region’s capital investment profile – often coinciding with the availability of infrastructure-focused matching funding programs – but the climb from 2005 to 2010 was steep and continuous. Both the volatility in investment patterns and the more recent upward trend suggest that municipalities act on infrastructure needs when they have the resources to do so and, particularly in the last five to seven years, when they have been focusing particular attention on these needs.

![Total Capital Expenditures - Rural Eastern Ontario](image)

**Figure 2 - Total Capital Expenditures (All Asset Types)- Rural Eastern Ontario**

4.2 Projecting Expenditure Patterns and Financial Requirements:

If future annual capital investments follow the trajectory of the 2007-2011 period, municipalities will be making capital investments of roughly **$436 million a year by 2020**. This is because 2007-2011 is characterized by a sharp increase in the 2008-2010 period but falling back down to 2008 levels in 2011. As is described in a later section of this Paper, this level of capital investment is insufficient to maintain current assets let alone address infrastructure deficits.
If instead, future investments follow the pattern of the 2000-2011 period in which capital investment increased by 96%, municipalities would be making capital investments of roughly $1 billion a year by 2020. In this case, municipalities would need to increase capital spending (on all types of infrastructure) by another $621 million a year by 2020. This level of infrastructure investment may well be needed in the years ahead; how it could be financed is another matter.

In 2011, 57 of the 103 municipal governments in Rural Eastern Ontario registered amortization charges higher than their capital investments in that year. The number of municipalities with capital spending that did not at least match declining values in assets doubled from 2010. Total amortization charges in Rural Eastern Ontario in 2011 were $264 million.

4.3 Annual Capital Expenditures – Transportation Services (2000-2011)

With 69,000 lane-kilometres of roads and 5,000 structures (bridges and large culverts)\(^3\), Eastern Ontario is responsible for nearly three-quarters of the region’s roads-related infrastructure\(^4\). As a result, Transportation Services assets are a major part of municipal capital investment budgets – far larger than the region’s population might suggest.

Capital investment in Transportation Services (primarily roads and bridges in Rural Eastern Ontario) totalled $1.6 billion in the 2000-2011 period, more than a third (38%) of the region’s total investment. Although the proportion varies year by year, capital investments in transportation services can account for 45 to 50 per cent of all capital investments in any given year.

Figure 3 - Capital Expenditures on Transportation Services - Rural Eastern Ontario

\(^3\) This information is drawn from the February 2012 Financial Sustainability Update report entitled “Facing Our Fiscal Challenges”.

\(^4\) The balance is the responsibility of the separated cities and towns plus Ottawa.
Investment in transportation infrastructure has been highly volatile through the 2005-2011 period, **peaking at $244 million** in 2010. This is almost certainly a response to capitalizing on time-limited cost-shared investment opportunities associated with federal-provincial stimulus funding.

Because investments in transportation infrastructure are long-term by nature (major investments in these assets are expected to have a useful life of at least 8-10 years – often much longer) – projections based on a ten year time horizon, backward and forward, are likely to be more useful than those based on a shorter, more volatile period. As a result, if municipalities in Rural Eastern Ontario continue to make capital investments in their transportation infrastructure at the same average rate as they did in **2000-2011**, annual capital investments will reach **$187 million a year by 2020**. This level of investment would mean municipalities would need to increase capital spending by **an additional $37 million a year by 2020** just to keep up the investment pace in transportation systems of the past decade.

Projected capital investment in transportation systems based on 2007-2011 and 2009-2011 patterns yield much lower investment patterns through to 2020 and are an example of how short timeframes create inaccurate predictions of future needs. As will be described in a later section of this report, even the projection based on the 2000-2011 period suggests a level of investment in transportation services that is almost certainly insufficient to maintain current assets let alone address the backlog/deficit from multiple years of constrained spending.

**Actual and Projected Operating Expenditures on Transportation Services**

Because rural municipalities may address a portion of transportation systems maintenance through operating rather than capital budgets (example: grading roads and applying fresh gravel, making improvements to drainage or guardrails), a complete picture of annual investments for maintaining transportation infrastructure must consider the substantial expenditures made each year through municipalities’ transportation-related operating budgets.

On average (over the 2000-2011 period), municipalities in Rural Eastern Ontario spent **$328 million a year on operating costs** for transportation systems. A large share of these expenditures are for such responsibilities as winter control (snow ploughing) or maintenance of lighting. However, if a quarter (25%) of the transportation services operating budget is being used to maintain or improve some portion of their roads and bridges infrastructure, it could be said that **total annual investment in the maintenance and improvement of transportation system assets have been roughly $230 million a year**. ($150 million a year in capital budgets and $80 million a year from operating budgets).
Operating Expenditures on Transportation Services

By 2011, transportation services operating budgets for local governments in Rural Eastern Ontario had reached $426 million a year. This is a 92% increase over the year 2000 with a 40% increase in the 2007-2011 period alone. (Considering both capital and operating expenditures, municipalities are spending a combined total of $478 billion a year on average on their transportation systems.)

If the rate of increase from 2007-2011 holds for the 2012-2020 period, local governments in rural areas of Eastern Ontario will be spending $750 million a year just to operate their transportation systems and services – this does not include any capital investment. If the pattern of expenditure evident in 2000-2011 holds for the balance of the decade, annual operating expenditures will be roughly $809 million by 2020. On a per household basis, these expenditures are expected to be $2,103 for each household – nearly double the per household operating expenditure requirements across the region in 2011 ($1,245).

If 25% of current operating budgets are deployed to support capital maintenance and improvement, municipalities will be investing $375 million to (re)build or carry out capital maintenance on transportation system assets each year ($187 million from capital budgets and $187 million from operating budgets). As is demonstrated in a later section of the Paper, this is still not enough to address the need for transportation infrastructure investment in Rural Eastern Ontario.
5. Municipal Capital Spending Not Keeping Up to Needs

5.1 Net Book Value of Capital Assets Continue to Decline

Comparing Net Book Value of capital assets (the value after depreciation is taken into account) to the Capital Cost (the value of the original capital investment) provides a measure of the degree to which municipalities have been able to invest sufficiently to maintain capital assets.

Municipalities in Rural Eastern Ontario held $8.71 billion in capital assets (valued at cost) at the end of 2011. After accumulated depreciation is taken into account, the book value of these assets is $4.97 billion. Using the ratio of these two statistics, Rural Eastern Ontario’s municipal assets have lost $3.74 billion in value, roughly 43% of their original value. In other words, these municipal assets are now worth 57.0% of their original value. This is down very slightly from 57.1% in 2009.

Although the timeframe used for projecting to 2020 is limited (just three years of data), the state of Rural Eastern Ontario’s capital assets (infrastructure) appears likely to continue to deteriorate in the 2012-2020 period, dropping by another fifth of a percentage point (to 56.8%) by the end of the decade. (Note that the same metric for the separated cities and towns is 57.6 % for 2011, projected to drop to 57.4% in 2020.)

Although not a major change in dollar value (roughly $175,000), the limited impact of significant stimulus funding (2009-2010) on preservation of capital assets funding suggests that municipalities need a period of sustained and significant investment to address their capital infrastructure deficit; it will not be addressed in just one or two years.

Figure 5 - Projected Change in Value of Capital Assets as Measured by Ratio of Net Book Value Divided by Original Cost

![Change in Value of Capital Assets Over Time: Net Book Value as Percentage of Original Cost](image)
5.2 Municipal Assets Per Household (Net Book Value)

Local governments in Rural Eastern Ontario held $13,169 in assets \textit{(at net book value)} for each household in the region at the end of 2011. This was virtually identical to assets per household in 2010 ($13,163) and up somewhat from 2009 ($12,075). This is likely the result of stimulus funding in 2009-2011 period. On a net book value basis, municipal assets per household are projected to increase slightly across the region by 2020, moving up to $13,894 per household. This increase would take place if as projected, the number of households in the region rises more slowly than net capital infrastructure spending (capital investment that exceeds depreciation).
6. Capital Infrastructure Deficit Now Stands at $3.74 Billion

6.1 Capital Infrastructure Deficit Continues to Grow

One way to estimate a capital infrastructure deficit is to consider the difference between the cost of assets and their (depreciated) book value. For municipalities in Rural Eastern Ontario, that gap is now $3.74 billion (2011) and has risen in each of 2009 and 2010. The increase in the infrastructure deficit in the 2010-2011 period ($270 million) represents the annual additional investment that would have been necessary just to keep the infrastructure deficit at roughly the same amount.

6.2 $374 Million a Year Required to Address Capital Infrastructure Deficit Over Next 10 Years

If addressed over a ten (10 year) period, the annual capital investment required to address the accumulated capital infrastructure deficit in Rural Eastern Ontario would be roughly $374 million each year. This amount would be used to rehabilitate or replace infrastructure that has seen significant deterioration since its original purchase or construction. This amount is in addition to the investment required to maintain these assets once they are returned to good condition or to maintain other assets that have not (to date) suffered significant deterioration (the $4.97 billion in asset value that is not part of the deficit calculation). (See section 6.3 for an estimate of ongoing capital needs).

Figure 9 - Calculation of Capital Infrastructure Deficit for Rural Eastern Ontario

<table>
<thead>
<tr>
<th>Capital Infrastructure Deficit Calc. for...</th>
<th>Value of Assets at Cost ($ Billion)</th>
<th>Book Value of Assets ($ Billion)</th>
<th>Capital Infrastructure Deficit ($ Billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural Eastern Ontario - 2009</td>
<td>7.65</td>
<td>4.36</td>
<td>3.29</td>
</tr>
<tr>
<td>Rural Eastern Ontario - 2010</td>
<td>8.09</td>
<td>4.62</td>
<td>3.47</td>
</tr>
<tr>
<td>Rural Eastern Ontario - 2011</td>
<td>8.71</td>
<td>4.97</td>
<td>3.74</td>
</tr>
</tbody>
</table>

Figure 10 - Calculation of Average Annual Expenditure Required to Address the Capital Infrastructure Deficit in Rural Eastern Ontario

<table>
<thead>
<tr>
<th>Annual Investment Requirements to Address Capital Infrastructure Deficit</th>
<th>Capital Infrastructure Deficit at 2011 ($ Billion)</th>
<th>Period Over Which Deficit to be Addressed (Years)</th>
<th>Average Annual Expenditure Required ($ Billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural Eastern Ontario - 2009</td>
<td>3.29</td>
<td>10</td>
<td>0.329</td>
</tr>
<tr>
<td>Rural Eastern Ontario - 2010</td>
<td>3.47</td>
<td>10</td>
<td>0.347</td>
</tr>
<tr>
<td>Rural Eastern Ontario - 2011</td>
<td>3.74</td>
<td>10</td>
<td>0.374</td>
</tr>
</tbody>
</table>

Note that roughly $3.0 billion of the total $3.74 billion capital infrastructure deficit is understood to be for roads and bridges. The 2012 Financial Sustainability Update report estimated the deficit for roads to be $2.48 billion with $526 million for bridges. This analysis was based on FIR and other data on the percentage of assets rated as being in good or very good condition combined with a set of field-derived assumptions on the costs of rehabilitating or extending the life of various types of roads and bridges.
6.3 $700 Million a Year Required to Maintain the Entire Capital Asset Pool

Beyond the resources required to address the accumulated capital infrastructure deficit, annual capital investments are required for capital maintenance on the entire $8.71 billion in assets under the care of municipal government.

Replacement cost rather than original cost must be considered when estimating the financial costs of addressing ongoing maintenance of capital assets. The replacement cost of virtually all municipal assets has increased markedly over the past decade. As a result, this analysis uses replacement cost of twice the original purchase price. (This is roughly equivalent to an annual increase in costs of 6.5% since 2000 and helps to take into consideration that there have been and will undoubtedly continue to be further cost increases as annual capital investments are made through to 2020. There is significant anecdotal evidence that the cost of materials and other inputs associated with municipal services has increased through the 2000-2011 period) well beyond the Consumer Price Index for the period.

Applying the replacement cost methodology to the 8.71 billion in capital assets and assuming renewal on an average 25-year asset life span, the investment required to maintain the capital asset base of local governments in Rural Eastern Ontario estimated at roughly $700 million a year. Assumptions of longer life spans would yield a lower annual maintenance cost and shorter life spans would increase annual maintenance costs.

![Figure 11 - Annual Investment Requirements to Address annual Costs to Maintain Assets](image)

<table>
<thead>
<tr>
<th>Annual Investment Requirements to Address Annual Costs to Maintain Assets</th>
<th>Replacement Value of Capital Assets ($x Cost) $2011 (Billion)</th>
<th>Annual Investment Required (Life: 25 years; $Billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural Eastern Ontario - 2009</td>
<td>16.30</td>
<td>0.61</td>
</tr>
<tr>
<td>Rural Eastern Ontario - 2010</td>
<td>16.18</td>
<td>0.65</td>
</tr>
<tr>
<td>Rural Eastern Ontario - 2011</td>
<td>17.42</td>
<td>0.70</td>
</tr>
</tbody>
</table>

6.4 Combined Capital Investment Needs Put Total Requirements at $1.074 Billion

If the resources required to address the capital infrastructure deficit ($374 million a year for 10 years) are combined with the resource requirements for regular capital maintenance ($700 million a year for 25 years), the total annual capital requirements to maintain the infrastructure in Rural Eastern Ontario is $1.074 billion.

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5 Original cost x 2, divided by 25 years.
If the full amount of capital expenditures in 2011 ($388 million) are deducted from the total $1.074 billion, the additional or new capital expenditures required for both purposes are $686 million a year. Note that these estimates do not include any provision for growth (new infrastructure beyond that which municipalities have today).

To address the existing capital infrastructure deficit AND maintain the $8.71 billion in municipal capital assets over the long term (25 years), local governments in Rural Eastern Ontario would have to spend an additional $686 million a year. Recognizing that fiscal 2012 is already complete and 2013 is now well under way, the projection above shows a rapid ramp-up starting in 2014 to the total required expenditure of $1.07 billion a year by 2020. How the need for these increased expenditures could be addressed is a major challenge for rural municipalities.
7. Three Ways For Municipalities to Finance Infrastructure Investments

7.1 Ways to Finance Infrastructure Investments

Municipalities have three ways to finance – or pay for – infrastructure investments:

- Use a portion of annual property tax revenues (or other user fees which would also be paid primarily by local residents and organizations)
- Draw down reserves (a time-limited option)
- Take on debt (the principal and interest repayment of which must come from property tax or other locally-generated revenues).

None of these methods – or even all three together – is likely to be sufficient to enable municipal governments in Rural Eastern Ontario to meet their infrastructure investment needs on their own in the current economic climate or without fundamental changes.

7.2 Property Taxpayer Contributions Reach A Billion a Year; Could Top $1.9 Billion by 2020

Municipal Own Purpose Revenues (local property taxes and user fees and charges) increased by 97% over the 2000-2011 period – from $540 million to more than $1.06 billion. If this trend continues, local governments in Rural Eastern Ontario will bring in $1.90 billion by 2020. This represents incremental revenue requirements of $84 million every year through to 2020. Even if every dollar of this revenue could be devoted to direct capital investment or financing costs for debt, this would be insufficient to address $686 million in additional annual capital investment.

Figure 14 - Property Taxpayer Contributions to Support Local Government in Rural Eastern Ontario
If total Own Purpose Revenues grew through to 2020 at the 2007-2011 rate (21% over 4 years) or the 2009-2011 rate (10% over 2 years), these revenues would be in the $1.54 to $1.57 billion by the end of the decade. On an annual basis, these increases represent additional contributions of $52 million a year from ratepayers, rising at the rate of 4 to 5% a year – still well above the Consumer Price Index and the increases in incomes that most people received in the last few years.

**Property Taxes Increases Average More Than 6% a Year Across the Region:**

Considering just property taxes (not user fees and charges), revenues raised by municipalities in Rural Eastern Ontario of “own purposes” (to pay for local services) rose from $409 million in 2000 to **$786 million in 2011** – an increase of **92%** over the period. This rate of increase is equivalent to a **6.1%** compound annual growth rate (CAGR) over the entire eleven year period. In a slightly shorter timeframe (2002-2012), the Consumer Price Index (CPI) for Canada rose by **21.8%**. It is clear that local governments have had to increase their draw from the local tax base at rates far higher than the CPI.

As is described in the forthcoming Ratepayer Affordability White Paper, roughly three-quarters of municipalities in Rural Eastern Ontario exhibit median household incomes below the provincial average. Unemployment rates tend to be higher in rural areas and the percentage of income from government transfers (rather than employment earnings) is significantly higher than for Ontario as a whole. Roughly a quarter of the region’s labour force works in another census division or county – again, significantly higher than for the Province as a whole.

*Without a change in the economic circumstances of Rural Eastern Ontario, continued above-CPI increases in property taxes are not sustainable.*
7.3 Municipalities Face Increasing Pressure to take on Debt to Finance Infrastructure

Between 2000 and 2011, debt held by local governments in Rural Eastern Ontario rose from $125 million to $556 million – an increase of 345% over the past decade. (The largest percentage increases were in the 2000-2005 period, leveling off thereafter; CAGR: 18%). If debt levels continue to rise at the 2000-2011 rate, local governments will have taken on a total of $2.1 billion in debt by 2020. If debt levels rise at the more modest rates of 2007-2011 or 2009-2011, they levels will reach $850-$875 million by 2020. It is likely there will be pressure to take on additional debt as a method of financing infrastructure investments, especially if past patterns of required municipal matches for federal-provincial infrastructure funding programs persist.

Figure 15 - Municipal Debt Levels Across Rural Eastern Ontario
7.4 Environmental Services Investments Account for Significant Share of Debt

Just 12% ($68 million) of debt currently held by local governments is related to roads and bridges; wastewater systems account for nearly twice as much ($126 million) with debt for water works and storm systems of about the same amount\textsuperscript{6}. In other words, debt has been far more extensively used for environmental services infrastructure than for roads and bridges. Debt financing is also used extensively to finance social housing\textsuperscript{7}, protection services, health services, and recreational facility assets. In many cases, municipalities have an opportunity through user fees and charges to earn back at least some of the revenues they need to service debt for these assets. This is more challenging for transportation systems (unless some form of toll charge was introduced). In a sense, financing needs for roads and bridges – which are substantial – are competing with many other infrastructure needs for a place in the debt financing queue. As a result, some municipalities may be using a portion of their transportation systems operating budget for lower-cost maintenance such as road grading or smaller drainage improvement projects (See section 4.3).

7.5 Rural Municipalities Are Using Roughly Half of Ministry-Estimated Debt Capacity

The Ministry of Municipal Affairs and Housing uses a formula based on 25% of Net Revenues to calculate the annual resources theoretically available to service debt (make principal and interest payments). Applying this formula to municipal revenues across Rural Eastern Ontario and using the Ministry’s calculation illustration of seven (7) % interest with a five (5) year term, the Debt Capacity for Rural Eastern Ontario’s municipal governments in 2011 was estimated to be $1.14 Billion. Given that roughly half of that debt capacity is already in use (these municipalities are currently carrying $566 million in debt), there is – at most – $575 million in debt capacity at the municipalities’ disposal.

Remaining debt capacity is not evenly distributed across municipalities. At the end of 2011, townships and towns (constituent municipalities within two-tier county systems) held nearly two-thirds of municipal debt ($346.7 million or 63% of the total). As a result, they were paying 63% of debt charges (principal and interest). Based on the MMAH formula for calculating debt capacity, these municipalities had $586 million in total debt capacity, of which 59% is currently being utilized. Twenty-seven (27) municipalities are currently using 75% or more of their debt capacity (as calculated using the MMAH formula).

\textsuperscript{6} Environmental Services will be considered in detail in the forthcoming White Paper on Environmental Services, scheduled for release in the fall of 2013.
\textsuperscript{7} Social Housing will be considered in detail in the forthcoming White Paper on Environmental Services, scheduled for release in the fall of 2013.
“Large area/small population” municipalities tend to have less debt capacity (because their annual revenues are smaller) but often have large capital infrastructure responsibilities. At the other end of the spectrum, 19 municipalities in Rural Eastern Ontario have no debt at all (according to 2011 FIRs). These municipalities may still have significant need for capital infrastructure investment.

**Debt financing alone will not address the region’s $3.74 billion capital infrastructure deficit.** Even if municipal governments agreed to push borrowing to $2.1 billion – and could finance it – thereby financing all the capital investment deficit redress with debt, this would be roughly double the Province’s debt ceiling estimates ($1.14 Billion) and the municipalities who were over their debt capacity would be considered to be in financial jeopardy.

**Figure 16 - Estimated Debt Capacity for Municipalities in Rural Eastern Ontario, based on MMAH calculation**

<table>
<thead>
<tr>
<th>Sub Region</th>
<th>Debt Charges - Principal for Current Year 2011</th>
<th>Debt Charges - Interest for Current Year 2011</th>
<th>Sub total Debt Charges 2011</th>
<th>Estimated Annual Repayment Limit</th>
<th>Debt Capable of Being Carried @ 7%</th>
<th>Debt Capable of Being Carried 7%, 5 Year Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural Eastern Ontario</td>
<td>45,176,154</td>
<td>24,429,533</td>
<td>69,604,671</td>
<td>234,702,414</td>
<td>1,137,110,590</td>
<td></td>
</tr>
<tr>
<td>Separated Cities</td>
<td>29,237,494</td>
<td>19,674,043</td>
<td>49,911,537</td>
<td>167,499,243</td>
<td>690,237,977</td>
<td></td>
</tr>
<tr>
<td>City of Ottawa</td>
<td>85,497,945</td>
<td>67,404,699</td>
<td>152,902,644</td>
<td>414,416,917</td>
<td>1,689,187,081</td>
<td></td>
</tr>
<tr>
<td>All Eastern Ontario</td>
<td>159,910,293</td>
<td>111,568,275</td>
<td>271,481,568</td>
<td>818,617,574</td>
<td>3,526,434,648</td>
<td></td>
</tr>
</tbody>
</table>

If municipalities used 100% of the Ministry-estimated debt capacity, they would reach their maximum with another $575 million in debt. The region as a whole would reach that threshold in fiscal 2014. This strategy would look after about 15% of the current capital infrastructure deficit (since current debt is already committed and is by definition not available to address the deficit). It could be said that additional debt could be used to leverage investments by other levels of government, in say, a 1/3; 1/3; 1/3 funding formula, thereby supporting a total of $1.74 billion in infrastructure investment. This assumes that sufficient matching funds are available in the next few years. The argument could be made that $1.74 billion would take rural municipalities a long way toward addressing infrastructure challenges – which it would. The question is: can they afford to service this debt? And can upper levels of government afford to participate in a cost-shared program?
7.6 Debt Service Costs Could Crowd Out Other Operating Expenditures

Debt must be financed – the principal must be repaid and interest on borrowing must be paid. In 2011, municipalities in Rural Eastern Ontario paid $69.6 million in principal and interest payments (debt servicing costs). Two-thirds of these payments ($45.2 million) are principal. Nearly two-thirds ($48.9 million) of the total costs are being born by constituent municipalities/lower tiers. These are annual revenues from property taxes that could otherwise go to cover annual operating expenditures.

The annual debt repayment limit for Rural Eastern Ontario as a whole, as derived from use of the Ministry of Municipal Affairs and Housing formula (25% of net revenues) is $234.7 million (2011). Therefore, it can be said that municipalities are using roughly 30% of their theoretical capacity to service debt ($69.6 million of $234.7 million). However, if municipalities took on additional debt to fully utilize the estimated carrying capacity, they would have to find $165 million a year in savings ($234.7 million less $69.6 million) from their annual operating budgets in order to be able to carry the debt servicing costs. In this sense, debt service costs could crowd out other operating expenditures on programs and services that are mandated, expected and valued by citizens.

If debt service costs rise through to 2020 by the same proportion as debt rises (to address the $2.1 billion projected debt in section 7.3, based on the 2000-2011 pattern), debt service costs would increase to roughly $355 million a year. Essentially own purpose revenues would have to increase at the same pace and all other operating cost increases would have to follow the same pattern as over the past decade. These rates of increase are not likely to be sustainable. The most aggressive scenario for Own Purpose Revenues would see them rise to $1.9 billion by 2020. Total operating expenditures are also expected to rise sharply, to at least $2.19 billion by 2020 (see Municipal Affordability White Paper for details).

*Without significant action on both the revenue and cost fronts, it is unlikely that additional fiscal room for debt servicing will open up by virtue of higher than expected revenues or lower than expected expenditures.*
7.7 Debt Servicing Costs Rising as Percentage of Total Operating Revenue

Based on projections from three historical scenarios, debt servicing costs are expected to increase by 57% (or about 6% a year) through to 2020 although the increases could be much higher if debt grows at the rate of the 2000-2011 period.

For municipalities in Ontario, financial risk from over-indebtedness is assessed on the basis of debt servicing costs as a percentage of total operating revenue. Across Rural Eastern Ontario as a whole, that ratio was 2.5% in 2009, rising slightly to 3.4% by the end of 2011. As a region, Rural Eastern Ontario would be classified as “low risk” according to the metric used by the Ministry of Municipal Affairs and Housing for individual municipalities. However, this regional ratio is an average of more than 100 municipalities. At the moment, most municipalities are in the “low-risk” category. However there are a few with debt servicing ratios higher than 10% (high risk). Roughly a quarter of municipalities are now in the moderate risk category (ratios of 5 to 10%).

If the debt trend exhibited in 2000-2011 continued through to 2020, debt servicing costs would consume 6.8% of total operating revenue – putting the region as a whole in the Ministry’s moderate-risk category. The crossover point for the region as a whole would likely be in late 2015/early 2016. Before that time, it is likely that growing debt levels – and higher debt servicing requirements – would begin to pose significant financial difficulties for some municipalities – especially those that are already in the moderate or high risk categories.

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8 The Ontario Ministry of Infrastructure notes that in 2011, 236 of the Province’s municipalities (57%) spent less than 5% of their total own-source revenues to pay debt servicing costs (principal and interest) on long-term financial obligations. Of those 236 municipalities, 69 did not have any debt servicing costs. Only 14 small, rural and northern municipalities (3%) paid more than 15% of own-source revenues in debt servicing costs. Source: [http://www.moi.gov.on.ca/en/infrastructure/building_together_mis/consultations-funding.asp](http://www.moi.gov.on.ca/en/infrastructure/building_together_mis/consultations-funding.asp)

9 In fiscal 2011, 71 municipalities (upper/single and lower tier) were classified as low-risk (ratio of less than 5%). 25 municipalities were considered moderate risk (ration between 5 and 10 per cent and 6 were considered high risk (ratios over 10 per cent).
Figure 17 - Debt Servicing Costs as a Percentage of Total Operating Revenue

Debt Servicing Costs as Percentage of Total Operating Revenue
Actual: 2009-2011; Projected: 2012-2020
8. Maintaining or Growing Reserves Will Be Difficult in Years Ahead

8.1 Rural Eastern Ontario Had $686 Million in Reserves at the End of 2011

At the end of 2011, municipalities in Rural Eastern Ontario had total reserves of $686 million, split between three types of reserve funds:

<table>
<thead>
<tr>
<th>Reserve Type</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obligatory Reserves</td>
<td>$120 million (earmarked for specific purposes by legislation)</td>
</tr>
<tr>
<td>Discretionary Reserves</td>
<td>$102 million</td>
</tr>
<tr>
<td>Reserve Funds</td>
<td>$464 million</td>
</tr>
<tr>
<td>Total</td>
<td>$686 million</td>
</tr>
</tbody>
</table>

Discretionary Reserves and Reserve Funds are used to manage cash flow for operating and capital expenditures within a fiscal year, to respond to in-year emergencies, and sometimes to provide the municipal match for infrastructure funding programs. As a result, the combined total for Discretionary Reserves and Reserve Funds ($566 million at the end of 2011) represent a reasonable estimate of the amount of reserve funds that local governments would have available for investment in capital infrastructure. Note that at $566 million, Rural Eastern Ontario has roughly 29% more reserves than the separated towns and cities in the region ($439 million). However, Rural Eastern Ontario also has much more capital infrastructure to maintain ($8.7 billion compared to $5.3 billion), particularly transportation assets (roads and bridges) and environmental assets (e.g. water and sewer)\(^\text{10}\).

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\(^{10}\) Rural Eastern Ontario has $7.08 billion in these two asset categories compared to $4.16 billion for separated cities and towns.
Rural Eastern Ontario
May have $845 Million in Discretionary Reserves by 2020

Projections for the total Discretionary Reserves and Reserve Funds likely to be available in 2020 suggest that local governments

8.2 Rural Eastern Ontario May have $845 Million in Discretionary Reserves by 2020
9. Taking Action on Municipal Infrastructure

Affordable municipal infrastructure will require local governments to change the trajectory of the costs and methods associated with infrastructure investment and maintenance as well as the revenues available for infrastructure purposes. The following recommendations cover some actions that local governments might take on their own or through the EOWC, as well as those which might be undertaken in partnership with upper levels of government.

Recommendations for EOWC and Constituent Municipalities:

E-1: It is proposed that the EOWC continue to actively support the development and implementation of a regional economic development strategy, with the long-term objective of stimulating growth as well as jobs across the region, which will in turn stimulate growth in the region’s tax base.

E-2: It is proposed that the EOWC create a regional infrastructure task force to explore ways to reduce the need for future infrastructure investments, reduce maintenance costs for existing infrastructure, and manage required infrastructure as efficiently as possible.

E-3: As part of the regional infrastructure task force, It is proposed that the EOWC lead the creation of a transportation infrastructure renewal network comprised of municipalities in Rural Eastern Ontario, to explore (among other topics) possible cost savings through collaborative action (examples: reducing costs through larger tenders and equipment sharing) and greater use of techniques to extend the life of existing assets. (A description of this network is contained in Appendix A.)

E-4: It is proposed that all municipalities in Rural Eastern Ontario be encouraged to ensure that their Asset Management Plans are complete by the end of 2013 as required.

Recommendations for the Province of Ontario:

U-1: It is proposed that the EOWC work in partnership with the Province of Ontario to design and to implement as soon as possible a permanent, predictable, non-competitive infrastructure fund designed specifically for small, rural and remote areas (See Appendix B for recommended design parameters).

U-2: It is proposed that the Province of Ontario continue implementation of the social services upload to 2018, thereby providing additional fiscal capacity for municipalities to address infrastructure maintenance needs as well as assisting in the provision of other critical municipal services.

U-3: It is proposed that the Province of Ontario provide Eastern Ontario municipalities that have significant Crown lands or other lands with assessment constraints (e.g. managed forests, farmland, aggregate sites etc.) within their jurisdictions with compensation reflecting these property-based limitations. The compensation could be a Payment-in-Lieu or an annual share of revenues accruing to the Province from these lands (e.g. royalties from stumpage fees). This compensation would be in recognition of the service provided by municipalities in building and maintaining roads and bridges, and providing emergency services for these tax-exempt lands.
Appendix A: Description of Transportation Infrastructure Renewal Enterprise (TIRE)

**Background:** In the course of bringing forward recommendations from the 2012 Financial Sustainability Update Project (*Facing Our Fiscal Challenges*), the EOWC received the suggestion that a new virtual provincial-rural network, known as the *Transportation Infrastructure Renewal Enterprise (TIRE)*, be created with the following scope of work:

- Share expertise and experience on the optimal use of road life extension techniques in rural areas
- Compare approaches to use of pavement condition indices (PCIs) or other methods for assessing the condition of transportation assets
- Increase utilization of more extensive joint tendering to increase the average size of tenders, make more effective use of equipment brought into/ Across the region
- Develop the best ways to maintain roads and bridges downloaded by the Province in 1998
- Develop recommendations for the best ways to address bridge infrastructure requirements (e.g. reconstruct vs. extend life/reinforcement decisions; multi-year financing mechanisms.

The reasons for the recommendation were: a) the large and dominant role that roads and bridges play in the infrastructure responsibilities of rural municipalities and the regional economy (roads and bridges are the region’s transit system), b) anecdotal evidence suggesting that many municipalities have developed ways of managing rural transportation systems that might be of benefit to their colleagues in other municipalities, and c) rural areas may have conditions and circumstances which a province-wide organization such as OGRA might not have the resources to address.

**Membership:** It is proposed that such a network be open to upper and lower tier municipalities with transportation services responsibilities and that collaboration with the Ontario Ministry of Transportation be sought to exchange ideas and information that would be applicable in conditions common across Rural Eastern Ontario (e.g. topography that makes road construction and drainage more challenging, large proportions of surface-treated roads, effective new pavement mixes, conditions under which pavement recycling is technically possible and cost-effective, addressing increased average annual daily traffic (AADT) due to seasonal traffic or proximity to major urban centres.)

**Governance:** It is proposed that TIRE would convene quarterly at different points around the region based on an agenda that facilitated presentations, discussions or working sessions within the scope of work described above. It is expected that TIRE would be self-funded with municipalities participating on a voluntary basis and volunteering to host the gathering if they have the facilities to do so. The EOWC could consider small amounts of funding to TIRE to cover the costs of presenters’ travel or basic refreshments for meeting participants. It is further proposed that participation be open to representatives of single/upper or lower tiers within EOWC boundaries, and that MTO be offered a standing invitation to participate in the events. It would be necessary to have a small executive team to launch and provide oversight for TIRE. At least initially, the executive team could be drawn from Roads Superintendents with an interest in making a regional contribution.
Appendix B: Recommendations on a Permanent Infrastructure Fund:

The Eastern Ontario Wardens Caucus (EOWC) recommends that the Province of Ontario design its proposed infrastructure fund for small, rural and Northern areas with the following principles in mind:

P-1: Allocate sufficient resources to the infrastructure program to make a real impact.

If the Province determines to establish the permanent fund at $100 million a year, the EOWC recommends that the Province also target to move total program funding to a minimum of $250 million a year by 2017 and $350 million a year by 2020. This scale-up recommendation is offered with an appreciation for the province’s current fiscal circumstances and is contingent upon definitions of “small, rural and Northern” as suggested in recommendation P-2.

In presenting this recommendation, the EOWC is mindful of the scale of past provincial support for infrastructure ($750 million a year via the Ministry of Transportation and $1 billion a year in conditional infrastructure funding). The EOWC notes that relatively few of the municipalities in Rural Eastern Ontario derive benefit from the provincial gas tax funding program. However, because of differences in program design, federal gas tax funding provides the region’s rural municipalities with more than $40 million a year. The design of Ontario’s proposed infrastructure funding program should deliver at least as much targeted support for small/rural municipalities in Eastern Ontario. This could be considered on the basis of a proportion of annual infrastructure funding through the proposed fund (e.g. 40% of $100 million).

P-2: Define “small, rural and Northern” to ensure that all three types of municipalities (single, upper, and lower tiers) found outside of major Ontario cities are eligible for the program and that lower tier municipalities are able to receive funds directly. The EOWC notes that responsibility for various types of infrastructure may rest with the upper tier, the lower tier or a combination of the two. Eligibility definition(s) must reflect this diversity in responsibility for infrastructure.

The EOWC recommends that population density be considered as the definition of “small, rural” and that for the purposes of design of the proposed infrastructure fund, eligible municipalities would be any upper or single tier municipality with population density of 50 persons per square kilometre or less. In the case of two-tier municipalities (counties), any lower tier municipality within a county with an overall population density of 50 persons per square kilometre or less would be considered eligible for infrastructure funding and could receive funding directly according to the allocation formula proposed in recommendation P-6.
The EOWC believes that population density is an effective, easily verifiable measure through which municipalities with small populations and large geographic areas of service can be targeted. These are the municipalities for which the Ontario Ministry of Infrastructure expressed concern related to per capita or pure population-based models; the EOWC shares these concerns. Getting the eligibility condition(s) right would also ensure that the proposed permanent infrastructure fund is focused on those municipalities that do not have transit systems as defined by the Provincial Gas Tax funding program.

P-3: Make the fund permanent, with predictable timelines for receiving and reporting on use of the allocated resources. A permanent fund will encourage annual and multi-year planning with corresponding improvements in tendering processes and securing services at reasonable costs. A permanent fund will allow both the Province and the municipalities to capitalize on comprehensive Asset Management Plans.

P-4: Make the fund non-competitive. To capitalize on recently-completed Asset Management Plans and the annual construction cycle, the EOWC strongly recommends an allocation-based system (similar to the Federal Gas Tax Program) rather than a competitive one. An allocation-based system allows municipalities to deploy their staff and financial resources to preparatory work that will be utilized – sometimes over several fiscal years – as the allocated funding becomes available. The uncertainty of an application-based system would contradict the Province’s encouragement for more effective long-term asset management and maintenance, and puts municipalities at a serious disadvantage when tendering for construction work.

P-5: Make the fund predictable – both in the amount of funding available in any given fiscal year and the allocations to individual municipalities. Municipalities need to know that a permanent fund will have at least the same monies available for allocation in successive fiscal years. Variations to the available funding each year will change the allocations to individual municipalities and negate at least some of the planning benefits associated with a permanent fund. In addition, predictability as to availability of funding within the fiscal year is also important. The infrastructure funding should flow as early in the fiscal year as possible to help municipalities make the best use of those resources in the busy, highly-competitive Canadian construction season.

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11 Ontario Ministry of Infrastructure: “The benefits of any program should also be considered in light of the amount of provincial funding available and the large number of rural and small communities in Ontario: the more municipalities receive funding, the smaller the grant each receives. The resulting grant amounts may be insufficient for municipalities to proceed with key projects.

An example of an entitlement program is one that distributes funds based on a population threshold. While this type of funding is stable and predictable, infrastructure needs are not determined by population size alone. For example, a community that covers a large area with an extensive road and bridge network with a relatively low population would be disadvantaged under a population-based model. An entitlement formula that accounts for the size and condition of municipal assets would allow funding to be better targeted to needs.” Source: Ontario Ministry of Infrastructure – MIS (MIII): http://www.moi.gov.on.ca/en/infrastructure/building_together_mis/consultations-funding.asp
P-6: **Apply a transparent allocation formula** that reflects a) the municipality’s ability to pay, and b) the scale of its infrastructure responsibilities. The EOWC expresses its willingness to work with the Province on a simple formula that allocates available funds across all eligible municipalities based on the extent of that municipality’s infrastructure asset base (considering all types of capital assets). As the Ontario Ministry of Infrastructure has noted, **Net Book Value is a simple measure of municipalities’ infrastructure responsibilities**, the data for which is submitted to the Province each year as part of the (audited) Financial Information Return (FIR). **The EOWC recommends that allocation of the proposed fund be made based on each municipality’s share of the total infrastructure assets held by eligible municipalities, measured by Net Book Value.** (For instance, if the Net Book Value of a municipality’s capital assets is 1% of the total Net Book Value of assets held by all eligible municipalities, that municipality would receive 1% of the annual funding from the proposed fund.)

Municipalities must also commit to using funds received for infrastructure maintenance/improvements above a threshold/baseline representing past investments. For example, the baseline might be set using a multi-year baseline of past expenditures. Municipalities must commit to using these funds for infrastructure investments (largely maintenance of existing assets) beyond the levels they have been able to make in past. These commitments to use of allocated funds would reference municipal infrastructure needs as set out in their Asset Management Plans.

It is further proposed that the Province of Ontario develop or design a feature into its proposed infrastructure funding program that will provide a funding supplement for municipalities making capital investments in roads and bridges that were part of the 1998 download. The detailed information on such roads and bridges is well-known to both the Province and the municipalities involved so the baseline data is easily verifiable. Where roadways run through multiple municipalities, the funding supplement could be contingent upon a collaborative approach by multiple municipalities.

P-7: **Give municipalities the responsibility to set their own priorities**, based on a completed and municipally-approved Asset Management Plan. Bill 92, passed into law in June of 2005 as the Municipal Law Amendment Act 2005, enshrined in law a Memorandum of Understanding (MOU) between the Province of Ontario and the Association of Municipalities of Ontario (AMO) that committed the Province to co-operating with local governments on issues that affect municipalities. The EOWC suggests that priority-setting on local infrastructure funding needs – which should be evident in Asset Management Plans – is consistent with this principle and reflects the diversity of municipalities across Ontario.

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P-8: **Ensure accountability for use of public funds** by requiring that funding be used to implement initiatives or plans which are referenced in the municipality’s Asset Management Plan. The only exceptions to this condition would be for emergency repair work or disaster recovery (e.g. damage from floods, fires or other natural disasters), which are presumably not predictable. The funding allocation should be portable, to allow municipalities to carry funds forward for a maximum of three (3) years, thereby facilitating large projects which cannot be accomplished in a single fiscal year. Such large projects must be referenced in the municipality’s Asset Management Plan.

P-8: **Use a simple, straightforward report on disposition of funds**, preferably with definitions, descriptions and budget lines that are consistent with data that municipalities submit with their annual Financial Information Return (FIR) or that are utilized by the federal census. Using data from validated sources also saves municipal and provincial staff time and avoids confusion. For example, Eastern Ontario municipalities have found the approach taken to reporting on infrastructure funding through the Federal Gas Tax program to be effective but not onerous in terms of staff time to complete. The report on disposition of funds should follow project implementation and be held to the same degree of scrutiny as applies for a FIR (since infrastructure expenditures would be audited by the municipality’s auditor).

*As the fund is established, the EOWC commits to work with the Province of Ontario to publicly recognize and give credit to the provincial government for its action on rural infrastructure and the improvements that take place across Eastern Ontario as a result.*