~ Closing The Gap ~

The Ontario Municipal Fiscal Situation
Issues and Future Directions

Pre-Budget Submission to The Standing
Committee on Finance and Economic Affairs

February 2, 2006
INTRODUCTION

When the Harris government downloaded services to municipalities it was argued to be “revenue neutral”. However, like the Province having inherited a projected $23 billion dollar funding gap from the Federal government, Ontario’s municipal governments have inherited an unsustainable, structural fiscal deficit from the Province.

Municipalities are no longer seen as mere wards of the Province. They are elected. They serve the same voter and taxpayer as other orders of government. They are a mature order of government. Municipal governments are not only recognized as far more than just important stakeholders, but as a partner with the Provincial and Federal Governments.

Yet, both the federal/provincial and provincial/municipal fiscal imbalances are damaging to Ontario’s communities and threaten the future prosperity of the province. Downloading from the federal government to the provincial government and from the provincial government to municipalities, while having improved the fiscal position of Canada and Ontario, continues to undermine the fiscal sustainability of municipalities.

Competing demands and limited fiscal resources are a reality for each order of government. However, Ontario is the only province in Canada that requires its municipalities to subsidize health and social services programs - to the tune of $3 billion dollars a year - and as a result, Ontario property taxpayers have the highest taxes in the country. Municipal governments are forced to defer investment in municipal services and infrastructure while individuals and families in Ontario’s communities watch services decline.

While municipal governments have worked at doing more with less, this has meant that municipalities have not been able to keep up with the capital infrastructure needs while trying to hold the line on property taxes. As a result of
these funding inequities, municipalities have incurred a deferred maintenance and delayed infrastructure investment that keeps growing by about $5 billion dollars a year.

AMO appreciates that the Provincial government has taken steps to shield municipalities from escalating costs in the areas of public health and child care, and is making a substantial offsetting investment in municipal public transit. However, a great deal more needs to be done if Ontario communities are to be livable, sustainable and competitive in the national and global marketplace.

Leading academics including Professor Harry Kitchen of Trent University, financial industry economists, public policy research institutes, selected Provincial elected officials, Municipal governments and property tax payers have argued that Ontario’s unique situation of requiring municipalities to subsidize provincial programs and provincial services is not good public policy and it is not economically sustainable. The resulting infrastructure deficit undermines the capacity of all municipalities to prosper and it limits their ability to compete internationally.

In speaking to the Standing Committee on Finance and Economic Affairs in December 2005, the Honourable Dwight Duncan, Minister of Finance himself acknowledged that, “...although municipalities have benefited from the gas tax and other recent measures - they continue to feel the effects of downloading from the previous government”.

Municipal services are vitally important, and no one disputes the municipal capacity to deliver efficient, quality front-line services. But, financing them and meeting capital needs is putting the health and safety of local communities in a precarious predicament.

A system that subsidizes the Province by $3 billion annually is not a system that supports communities. It is not a system that supports accountability for
municipal property taxpayers. And, it is not a system that creates opportunities where opportunities are needed most.

The Municipal Fiscal Dilemma

No group identifies more closely with Ontarians than municipalities - each proud to play a large part in building strong, productive and competitive communities across Ontario. Ontario municipalities govern and provide vital services to more than 1/3 of Canada’s population.

We construct, maintain, and operate the entire spectrum of facilities required to deliver water and sewer services, transit and transportation, waste management, cultural and recreational centres, plus parks.

In the information age, viable, safe, well-serviced communities attract jobs and investment. Yet, growing responsibilities and shrinking resources are stifling our communities, large and small.

There is a gap between what Ontario takes from municipalities and what it gives back to municipalities. Like the $23 billion more Ontario contributes to the federal government than it receives, Ontario’s municipal governments have inherited an unsustainable, structural fiscal deficit, as illustrated below:
While Canada and the provinces have been reducing income taxes to become more competitive with other countries, the burden has shifted to consumption and property taxes, with property taxes being the most regressive of the three, with no link to income, ability to pay or inflation.

In 2004, Ontario’s Municipal governments had operating revenues of approximately $26.6 billion, including $12.1 billion in property tax revenue - accounting for 45.5% of total revenues in 2004/05, the largest share.\(^1\)

However, municipal revenues grow slower than other governments’ revenue sources. Even with cuts to various income tax rates, income tax revenue grew 2.5 times faster than property taxes, as illustrated in the attached graph:

![5-Year Government Revenue Rates of Growth (1997/98 – 2001/2)](image)

Sources: AMO with data from Statistics Canada

Between 1988 and 1998 Ontario’s per capita municipal spending increased by almost 40% compared to a 10% increase for the rest of Canada.\(^2\) Although wide variation exists in the level of per capita property taxes across Canada, Ontario remains the highest (2001 data).\(^3\) For the average family of two or more persons in Ontario in 2003, municipal property taxes were 35% more than the comparable

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\(^1\) Social Services and Health Breakdown, 2004.  
family in the rest of Canada and 15% higher than the next highest, Saskatchewan.  

Why? Because provincial services including social services, housing and health are funded by property taxes to a much higher degree in Ontario; and, due to the virtual elimination of provincial transfer payments to municipalities equivalent to hundreds of millions of dollars. Municipalities continue to subsidize the provincial treasury for provincial health and social services programs for a net total of more than $3 billion dollars a year (see attached Appendix “A”). The ability of municipalities to make vital and much needed investments in infrastructure is compromised by this increasing reliance of the Province on the municipal property tax base.

This leaves property tax payers feeling that they are highly taxed and debt-weary. The result is that Municipal governments are forced to defer investment in municipal services and infrastructure while individuals and families in Ontario’s communities watch services decline.

A municipal government’s inevitable reaction to an overwhelmed property tax base is to squeeze what little control we do have in terms of discretionary funding, and force cut backs in service areas. Deferred infrastructure and investment and reduced services in the community is a direct result. The municipal goal is to deliver quality services to residents at a reasonable, sustainable and defensible property tax burden instead of the current tax burden, which is already the highest anywhere in Canada.

Quality infrastructure has come to be regarded as more than a system of highly developed transportation and communication networks; it now includes those features, such as cultural and recreational activities, housing choices and the

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4 Fraser Institute: Taxes Across Canada (February 2004).
quality of the educational system, which are deemed to be essential to attract talented people to live and work in a particular area.

Yet, years of neglect have left Ontario’s infrastructure in a critical state of disrepair - roads, bridges, sewer and water systems, transit, schools, parks - all making it possible to live and work across Ontario, yet whose future existence is threatened. Experts across Canada agree that municipalities are facing an “infrastructure gap” or “deficit”\(^5\) - the need to fix and replace decaying, outdated or inadequate public systems without available funds to do so. An issue estimated to be in the magnitude of $60 billion across Canada, growing by $2 billion every year.

The Ontario Government’s Water Strategy Expert Panel released its report on Ontario’s water infrastructure, estimating that Ontario would require $11 billion in deferred maintenance in Ontario - and a $34 billion investment in water systems alone over the next 15 years. Local revenues that should have been allocated for local water and sewer infrastructure were used to pay for provincial disability, welfare, and drug benefits instead. If we were not subsidizing the province for the last 10 years, that $3 billion gap could have resulted in a $30 billion dollars in potential infrastructure investments.

Consider for example the City of Ottawa, which sites a $200 million to $250 million dollar infrastructure deficit. They are $50 million dollars short for capital projects, and must spend more than $1 billion dollars on infrastructure over the next decade. Yet, without the guarantee of stable financing, it is too risky to start much needed infrastructure improvement projects.

The infrastructure pressure tops $1 billion dollars in the City of Hamilton as well. The City is about $150 million dollars behind on road repairs, $300 - 500 million dollars are needed for sewer and water programs, and $50 - 100 million dollars

are required to upgrade various facilities, including rinks, arenas, pools and civic buildings.

These issues aren’t exclusive to larger more urban centres - the Northwest Ontario community of Greenstone is facing aging infrastructure, including roads, water systems, and ancient sewage treatment plants, all of which makes it difficult to attract new industry to create jobs and stabilize the tax base.

As long as the Province relies on Municipal government’s property taxes to subsidize their service and program costs, Ontario's Budget can never be “balanced” in the true sense of the word.

Access to new tools, new programs and new funding initiatives will take Municipal government a little further, but ultimately, we need to wean the Province off of municipal property tax revenue.

Consider the Provincial and Federal investments in transit and environmental sustainability. It all sounds great - until you realize that even when the Ontario’s share of Gas Tax Revenue reaches $746 million annually, it will fall short of what is needed to shrink our annual $5 billion dollar infrastructure deficit.

There is a growing understanding of the challenges that municipalities are facing. In his speaking notes to the Standing Committee on Finance and Economic Affairs, the Honourable Dwight Duncan, Minister of Finance himself acknowledged, “...although municipalities have benefited from the gas tax and other recent measures - they continue to feel the effects of downloading from the previous government”.6

Municipal government understands that it will take time to fully reconcile both the Federal-Provincial and Provincial-Municipal fiscal arrangements, and that the imbalance that remains that undermines the financial sustainability of local

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6 Notes for remarks by the Honourable Dwight Duncan to the Standing Committee on Finance and Economic Affairs, December 15, 2005.
communities across Ontario will not be solved overnight. However, property taxes should not and cannot continue to bail the province out of its fiscal situation.

“The property tax system, when it comes to paying for social services, is a recipe for disaster”. We all know it, as does the current government, because that is a direct quote from Premier McGuinty, as Leader of the Opposition back in 1997.

As Leader of the Opposition, Mr. McGuinty also said that the Harris government “… had better return to the drawing board now and come up with a better solution fast before they do any more damage.” Now Premier McGuinty’s government has an opportunity to go back to the drawing board and Municipal governments and the people and businesses in Ontario’s communities are counting on him to do so.

The Provincial Government’s 2005 Economic Outlook and Fiscal Review confirms that Ontario’s economic growth has exceeded expectations during the first half of 2005, leading the Ontario Ministry of Finance to increase its growth assumption for 2005 to 2.2 per cent, up from 2.0 per cent forecast in the 2005 Ontario Budget. The projections are toward anticipated continued solid growth for Ontario’s economy in 2006 and 2007.

In 2004-05, the deficit was reduced to $1.6 billion – down from $5.5 billion when the government took office. As was stated in the 2005 Ontario Budget, the deficit will be eliminated slightly ahead of the plan no later than 2008-09, or a year earlier, in 2007-08, if the reserve is not required. Ontario is heading toward a strong and stable fiscal environment and this should be reflected in the context of the provincial-municipal fiscal relationship with a reduction in the province’s reliance on municipal revenues to fund provincial programs and services.

As Ontario’s fiscal situation improves, the Ontario government has an opportunity and a responsibility to work with the municipalities to develop a plan to reverse
the decline brought on by unsustainable fiscal arrangements established by the previous government, and made worse by this government.

Ontario municipalities need long-term, structural solutions. We need a sustainable financial framework. One that matches appropriate revenue streams to the services we’re mandated to provide. New revenue tools might be helpful to some municipalities but that they will do nothing to address this $3 billion provincial-municipal gap that undermines the future of communities in every part of Ontario each year.

At a minimum, the Province should commit to a gradual upload of cost-sharing tied to the $3 billion dollar subsidy for health and social services programs - with a view to its eventual elimination over a practical period of time. The time is now.

**Municipal Operation Expenditures and Revenues**

“Financing Canadian municipalities is an increasing concern in today’s environment of downloading and reshuffling of provincial-municipal responsibilities”. ⁷ Although a statement made in 2000, post local services realignment, the questions posed by the author in terms of provincial use of the municipal property tax base, municipal access to alternate revenue tools, and municipal decision-making and funding responsibilities are still relevant many years later.

Municipal revenue consists of grants (primarily conditional and from the Provincial government) and funds generated from own sources including property taxes and user fees with small amounts from investments and a miscellaneous collection of amusement taxes, licenses and permits, and fines and penalties.

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Transfer payments, the third largest source of income for provincial and territorial governments, have also declined relative to total revenues. However, the ratio of transfer payments to total revenues has been rising steadily since 2000/01. This reflects increased federal contributions through health and social transfer payments.

The fiscal situation for municipal governments has become increasingly untenable. As a result of a convergence of factors, namely a beleaguered property tax base suffering from provincial and federal downloading and drastically reduced transfer payments, and rapid population growth in some areas, most municipalities find themselves trying to provide high quality programs and services to their residents at a time when costs have been rising and/or revenues have been shrinking\(^8\).

In the 2002 Speech from the Throne\(^9\), the Federal Government supports the need for strong communities in identifying the future prosperity of this country on our ability to create and maintain world-class communities:

> Competitive cities and healthy communities are vital to our individual and national well-being, and to Canada’s ability to attract and retain talent and investment. They require not only strong industries, but also safe neighbourhoods; not only a dynamic labour force, but also access to a rich and diverse cultural life. They require new partnerships, a new urban strategy, and a new approach to healthy communities for the 21\(^{st}\) Century.

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\(^8\) Mau, T., “Political Rhetoric or Genuine Leadership: An Assessment of the ‘New Deal’ for Cities”, presented at the Annual Meeting of the Canadian Political Science Association, University of Western Ontario (June 2005).

However, the fundamental revenue problem that municipalities in Ontario face is that the Province takes $3 billion of municipal revenue away from municipalities each year to fund a range of provincial health, social services and income redistribution programs.

The resulting pressure on the municipal property tax base translates into Ontario spending a proportionately lower percentage of municipal expenditures on transportation (e.g., roads, streets, snow removal, public transit), and environmental (e.g., water, sewage, solid waste) services due to this large municipal spending on social services.

In an examination of major interprovincial spending similarities and differences for the entire municipal sector across Canada (cities, towns, villages, townships, counties, regions and districts), it was noted that social services are almost entirely a provincial funding responsibility in every province except for Ontario where, as of 2002, they account for 25% of municipal spending from the property tax base\textsuperscript{10}. In municipalities outside of Ontario, such costs account for only 1.2% of municipal expenditures\textsuperscript{11} (see attached Appendix “B”).

Consider, for example:

- In the City of Hamilton in 2004, approximately 36% of its gross Budget, or 22% of its net Budget, was attributed to social assistance, public health and social housing costs;

- In Peel Region, in 2005, $270 million, or 45.3% of the Region’s tax levy was for provincially mandated health and social services (including land ambulance and housing). On average, Mississauga residents paid $704 (21%) per home in taxes for health and social services in 2005 and another

$959 (28%) in provincial education taxes. Amazingly, almost half the local property tax base (49% or $1,663 per home) is for Provincial services.

**Impact of Local Services Realignment (LSR)**

In January 1997 the Government of Ontario announced comprehensive reform of the provincial-municipal relationship under the banner of “Local Services Realignment”. The initiative led to Bill 152, *An Act to improve Services, increase Efficiency and benefit Taxpayers by eliminating Duplication and reallocating Responsibilities between Provincial and Municipal Governments in various areas and to implement other aspects of the Government’s "Who Does What" Agenda*, otherwise known as the *Services Improvement Act, 1997*.

The Province argued that this exercise would reduce duplication and overlap in service delivery, promote a more accountable, less costly government, and simplify government structure. Although intended as an exercise to “disentangle” provincial/municipal roles and responsibilities, LSR in reality resulted in the further “entanglement” of the cost sharing arrangements across 16 programs cumulating in a transfer of approximately $2.5 billion in net costs to municipalities.

Municipalities were in turn given responsibilities for a number of social programs, including social housing, land ambulance, and public health as well as police, transit, and water and sewer systems. In exchange, the province provided $2.5 billion in residential property “tax room” to municipalities. Provincial boards of education were required to relinquish their hold on the property tax - designed to “free up” municipal resources to pay for the new service responsibilities under LSR by reducing their financial obligations for funding school boards.

By raising the same total amounts in local taxes as before, municipalities were told that they would then have an additional $2.5 billion to fund the transferred LSR programs by raising their municipal tax rates accordingly. However, in
reality, this “tax room” was a misnomer - those municipalities that did utilize it by raising property taxes were criticized by the government for failing to pass on “savings” to taxpayers!

The download exercise was consistently advertised to municipalities as "revenue neutral" - the principle that neither government should incur greater costs as a result of the imposed changes. In fact, the Province initially stated that there would be a slight benefit to municipalities resulting from this process!

In reality, municipalities immediately began to experience the mandated provision of additional services without any corresponding increase in provincial support. Not only did the Provincial notion of “revenue neutrality” include Provincial-established “savings targets” for municipalities of approximately $500 million, the accuracy of the provincial cost figures with regard to “neutrality” were of serious question within a few weeks after the initial announcements. Omission of the loss of unconditional grants in this calculation that were valued at some $600 million for municipalities contributed to total municipal funding shortfall of over $1 Billion.

In the end, the final outcome of this Provincial exercise was a massive “download” onto municipal governments, resulting in windfall savings to the Province with the municipalities having to account for the difference through increase property taxes or user-fees. There were resulting significant inequities between the large urban centres and smaller municipalities due to their larger share of social services, the province maintained policy control over human services program despite municipal contributions (a violation of the “pay for say” principle), and property tax was used to pay for income redistribution programs - potentially undermining the stability of municipal revenue sources.

The Ontario Government’s own Gerry Phillips, when in opposition and debating the passage of Bill 175, An Act to authorize the payment of certain amounts for the Public Services for the fiscal year ending on March 31, 1998 (otherwise
known as the Supply Act, 1997), criticized then Premier Harris stating, “Nobody thinks it’s right to put social housing and social assistance on the property tax - nobody. It is fundamentally wrong. Ontario will rue the day that happened”. As well, Mr. Phillips addressed the issue of savings targets for municipalities as “insulting” and “laughable”.

Even then Leader of the Opposition, Dalton McGuinty warned the government that with these changes “… we are going to see higher property taxes, we are going to have fewer services and we’re going to have more user fees.”

Years later, the LSR continues to have a significant impact on municipal budgets. For example:

- In the City of Peterborough 36.6% of the City’s gross expenditures and 25.6% of the City’s net expenditures for 2005 relate to services affected by the LSR over which the City has very little effective control (see attached chart Appendix “C”).

- Across the twelve Counties of Eastern Ontario the LSR deficit continues to grow. Following the introduction of LSR for the period of 1998 to 2001, most Counties were found to be in a positive position. However, 2002 saw a funding shortfall of $1.2 million and an additional shortfall in 2003 of $3.6 million after the 2003 reconciliation. The 2004 shortfall is $8.3 million, excluding the initial required savings target of approximately $5 million per year.

- In the last eight years since provincial downloading through LSR, Chatham-Kent has had to manage the effect of $6.5 million in annual costs due to downloading, and $6 million in one-time costs. This is money that could have been invested in local infrastructure and the municipality’s deficit in this area could have been decreased by an estimated 17%.
Over the past decade, the result has been a succession of provincial band-aid formulas to fix the “problem” of fiscally strained municipalities, deteriorating local services, and a growing awareness among the public that the download has harmed Ontario’s communities of all sizes.

The Community Reinvestment Fund (CRF)

The Community Reinvestment Fund (CRF) was established in 1997/98 with the objective of ensuring that what was considered by the Province to be a fair and even realignment of responsibilities and costs related to 16 programs remained “revenue neutral” for municipalities.

This transfer of responsibilities from the province to the municipal level resulted in an increasing reliance by municipalities on own-source revenues given that programs once funded from a broad provincial funding base were then reliant on the municipal property-tax spending base. The design function of the CRF was to provide municipalities annual payments that effectively made up the difference (i.e., the “gap”) between net LSR costs transferred and municipal tax room.

“Revenue neutrality” was to be achieved annually - not just between the government and municipalities as a total, but between government and each individual municipality. A premise that, while not enshrined in legislation, was reinforced by the Minister of Finance to Heads of Council when the program was introduced in 1998.

Although a formulaic approach to distribution of funds is a desirable approach to any funding program - as opposed to discretionary or negotiated transfer payments - the essential ingredient in any such program are grants based on municipal needs (e.g., population, type of municipality, or some other measure) and municipal fiscal capacity (e.g., ability to raise resource with the revenue
authority at their disposal)\textsuperscript{12}. With its focus on the gap between LSR costs transferred and so-called property tax room, the CRF missed the mark in addressing the full range of municipal expenditure \textit{needs} and \textit{fiscal capacity}.

Although the CRF provided some equalization in the sense that proportionately more money went to poorer municipalities, it was not based on fiscal capacity and subsequently compromised the ability of all local governments, even the smallest and the poorest, to provide a basic package of local services.

Based on a report conducted by the Provincial Auditor of Ontario in 2001\textsuperscript{13}, there were several observations made about the government’s objective to ensure “revenue neutrality” of the LSR initiative through CRF entitlements:

- For programs fully transferred to municipalities, LSR costs for the purpose of determining CRF entitlements were frozen at the amounts existing at the time of the program transfer. Hence, the actual costs incurred by municipalities in subsequently delivering these programs were not taken into consideration.

- For cost-shared and provincially administered programs, LSR costs for the purpose of determining CRF entitlements were frozen at 2000 amounts (actual 1999 year-end costs with a payment adjustment to reflect 2000 costs), rather than the actual expenditure levels for 2001.

- The CRF allocation formula factored in the provincially imposed savings target of $500 million annually on total municipal spending. Not only was there little empirical or analytical support for this arbitrary target, but municipalities were then in a position of finding savings in programs they do not control.

\textsuperscript{12} Bird, R., \textit{Intergovernmental fiscal relations: Universal Principles, Local Applications}. Georgia State University, School of Policy Studies. Working Paper #00-2 (April 2000).

• The provincial approach in applying the savings target resulted in differences between municipalities such that some received windfall gains and others experienced a significant negative fiscal impact. The municipal savings targets have remained unchanged since 1998.

• The municipal tax room component of the CRF formula did not reflect changes to the assessment data, including changes in the province-wide current value assessment (CVA) initiative.

• The amount of education “tax room” available varied between municipalities because not all municipalities had equivalent taxing ability (i.e., resources available) and this was historically accommodated through the Provincial education grants system. What resulted was that the “poorer” the school board, the higher the education grant made available, and the lower amount that could be raised from the property tax. With less education tax room freed up, these municipalities received a higher CRF.

Furthermore, in March 2000, several CRF-related monitoring procedures were imposed on CRF fund allocations such that a municipality could no longer allocate CRF funds to reserve, and if the government determined that a CRF entitlement was not being used in a manner that benefited current year taxpayers, the province could reallocate CRF payments to those municipalities considered to be in greater need.

Following the 2003 provincial election, it became clear to officials at the Ministry of Finance that the CRF they created was no longer in line with what the provincial budget estimates accommodated. Since the LSR, the costs to municipalities of CRF eligible services had escalated dramatically, and were projected to increase steadily - driving up the government’s CRF liabilities. In December 2003, as part of the government’s response to fiscal constraints, the government announced that CRF financial reconciliations for the years 2003,
2004 and beyond were unlikely. The government indicated that the CRF allocation for 2004 would be $618 million based on actual costs for 2002.

For 2002-03, the province provided $582 million in that community reinvestment fund to municipalities. However, there were costs associated with reconciling for both 2003 and 2004. Given cost escalations beyond the control of the municipalities delivering the CRF eligible provincial services, the Government’s CRF liability to reconcile with municipalities would have escalated every year afterwards.

Some of the most common complaints about the Community Reinvestment Fund (CRF) were that it was difficult to understand; that communities with similar characteristics, populations and costs were receiving completely different sums of money; and, that necessary achievement of savings targets was impeding the flow of money to municipalities.

Although the CRF did provide partial mitigation to some municipal governments (albeit not a permanent solution) and incorporated an annual reconciliation process toward achieving fairness, the adjustments have been considered by municipalities to be crude and not all municipalities have benefited.

Consequently, in an effort to find a more “equitable” way to provide its marginal offset to LSR costs, the government announced a process to review the CRF in consultation with AMO. Operating on the shared provincial/municipal principles of equity, fairness and accountability; working towards reducing the provincial dependency on the property tax base to fund income redistribution programs; and, achieving greater municipal autonomy, the primary objective of the review was to replace the CRF with a simpler, more understandable, more transparent system that is sustainable and predictable over the long-term.
The Ontario Municipal Partnership Fund (OMPF)

There are a number of elements that are consistently found in the writing of economists and government experts from around the world with respect to design of intergovernmental transfers. In a document prepared for the *Expert Panel on Equalization and Territorial Formula Financing* (May 2005), Ontario writer Harry Kitchen evaluated the strengths and weaknesses of a range of potential grants, and identified principles ideally used in developing an unconditional transfer system formula, including:

- **Fairness or equalization** - a system that considers needs and resources affecting the ability of the municipality to control expenditures, and when municipalities with equal fiscal need (i.e., as a measure of expenditure needs relative to ability to raise own revenue) are treated equally.

- **Economic efficiency or choice neutrality** - the degree to which a grant alters or influences the expenditure patterns or spending priorities and usurps the decision-making authority of the municipality.

- **Predictability, stability and flexibility** - allows municipal governments to budget and plan for the future and reflects changes in local circumstances.

- **Accountability** - public documentation of qualification and spending according to formula.

- **Transparency** - easily understood and calculations able to be replicated to verify accuracy.

- **Sustainability** - long term commitment of funding against obligations allowing for planning and certainty of the municipality to meet debt charges.

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AMO February 2006
The Province identified several design principles in their consideration of a replacement to CRF toward a fairer, more transparent program providing similar funding to municipalities:

- Assists municipalities with their social program costs;
- Includes equalization measures;
- Addresses challenges faced by northern and rural communities; and,
- Responds to policing costs in rural communities.

In discussions between the municipal sector and the provincial government prior to the announcement of OMPF, AMO made it clear that replacing CRF would require more money than was currently available through CRF, that the issue of the provincial-municipal cost-sharing $3 billion gap would require redress, and that municipalities would require time to adjust to a new grant formula.

After lengthy discussions and no consensus, the Government announced a new funding model in March 2005, replacing the CRF with the “Ontario Municipal Partnership Fund (OMPF)” as the Province’s main transfer payment to municipalities.

When the Government introduced OMPF they emphasized it as a “clear and transparent system of grants” as part of their on-going commitment to strong communities: providing $656 million to 386 municipalities (or 87 per cent) in 2005. This represents a $38 million or 6.1% increase over CRF funding received in 2004. However, the 2005 Provincial OMPF allocation was in reality an arbitrary amount determined by provincial funding priorities rather than based on the principles of municipal need and fiscal capacity. In fact, the OMPF distributes less funding than what the CRF would have distributed had it continued if one-time CRF reconciliation costs are factored into the equation.

However, the continued shortfall of funding necessitated a “stable funding guarantee”, providing municipalities with one-time transition funding with a view
toward meeting the 2003 and 2004 reconciliation obligations under the CRF model, and to ensure a manageable pace of change. The Government reassured municipalities that they would receive, at minimum, as much funding in 2005 as they received through the CRF in 2004. But, after 2005, the OMPF was designed to reallocate resources dramatically.

While there have been some positive impacts from OMPF on a regional basis, many municipalities across Ontario continue to identify specific concerns about the ability of OMPF to ensure that all municipal governments have a financially sustainable future.

Any new funding system should be transparent, sustainable, equitable, and responsive to changes in circumstances, and reflect the link between taxation and municipal services as well as “pay for say”. Overall, OMPF is inadequately funded and with clear “winners” and “losers” between municipal grant recipients it compounds the current municipal fiscal dilemma and pits municipalities against each other. It is neither equitable nor sustainable.

The total funding allocation of $656 million (for 2005) dictated the parameters of the OMPF program. This is a major design flaw. The true costs incurred by municipalities to fund provincially mandated programs in health care, income redistribution and broader social service programs should have been the starting point of a true “partnership” funding arrangement and in turn used to establish the parameters of the various components of the program.

As municipal expenditures continue to increase outside of Council’s control, municipalities are faced with a formulaic grant system that perpetuates funding inequities across municipalities. The financial impacts for municipalities facing reductions through OMPF are not sustainable or realistic. The further distancing of Provincial government financial support from the actual costs for downloaded provincial services will force property taxpayers to continue to make up the difference.
The resulting OMPF is considered a partial measure that ignores the fundamental and unworkable problems associated with using the municipal property tax base to finance provincial programs.

Some specific municipal examples of issues with OMPF include:

- Municipal officials identify that Chatham-Kent is facing a $4.3 million dollar impact in 2006 due to the OMPF - with projections that this will grow to $12.9 million by 2009. This equates to a 9.7% property tax increase and likely services level reductions to tackle this projected fiscal pressure.

- In Chatsworth, the replacement of the CRF with the Ontario Municipal Partnership Fund means that Chatsworth is no longer compensated for the download of the Farm Tax Rebate. For Chatsworth, the shortfall would be $280,000, the equivalent of a 16.5 per cent tax increase. For all of Grey County municipalities, the shortfall would equate to more than $5.5 million.

- While the City of Hamilton is the largest recipient of OMPF funding under the Social Programs Grant, to the tune of $30 million, it continues to have one of the highest ratios of property taxation relative to household income.

- The property tax levies for the Eastern Ontario counties have increased by an average of more than 27% since 2002, and in 2005, a non-assessment year, by 10%. OMPF leaves the Eastern Ontario counties with an estimated shortfall in excess of $19.5 million. This deficit will continue to grow as the stable funding guarantee, of $16.3 million, is phased out. Lower tier municipalities require this funding guarantee to manage the cost of their services and infrastructure needs. If the new grant system fully matures, in 2005, there is an estimated shortfall of $19.5 million in provincial funding support for the LSR services and the total OMPF annual deficit at maturity will
be approximately $35 million for these counties, which represents 15% of the 2005 property tax levy.\textsuperscript{15}

- The Equalization Grant component of the OMPF gives special consideration for farmland and managed forests, but does not make any allowance for Crown Lands.

- Reallocation of provincial funding support for municipalities in the name of “fairness” hits counties with major shortfalls and fails to recognize the gradual migration of ever-increasing service costs to property taxpayers over the past five years. There is no evidence to support that these costs will not continue to increase at levels well beyond normal rates of inflation in future years.

- Given that the Police grant is tied to rural qualifiers, all small urban municipalities have been effectively disqualified for funding. These were municipalities that spend a large percentage of their budget on policing, and were supposed to be helped by the new OMPF formula; but, have fallen through the cracks.

- The OMPF has been criticized for its approach to account for a community’s unique rural/urban mix. Under LSR, the province eliminated the Farm Tax Rebate program by reducing the farm tax rate to 25%, resulting in a decrease in municipal property tax revenue, for which the municipalities were compensated in part through the CRF. The OMPF only partially mitigates this impact, by differential provincial support determined by the proportion of farm property assessment to total local assessment.

Subsidization of the Farm Tax burden is a matter of provincial agri-food policy rather than a matter for local determination funded by the municipal property tax base. Similarly, the Managed Forest Tax reduction program, again a

\textsuperscript{15} Allan & Partners Inc. \textit{Eastern Ontario Counties: Future Directions} (August 2005).
provincial policy initiative is differentially locally funded through the OMPF. Both programs should be provided from provincial revenue sources.

• The Ontario Municipal Partnership Fund does not replace the one-time mitigation funding previously provided under the CRF. However, these costs, which stem largely from social program costs, are recurring, and therefore experienced on an annual basis. Hence, the OMPF is arguably further downloading costs to local communities with limited access to revenue sources. Other municipally delivered services not specifically addressed within OMPF include:
  o Land ambulance (municipal share)\textsuperscript{16}
  o Roads and bridges
  o Social Housing (capped at 2002 rates)
  o Social Housing infrastructure deficit
  o Unpatented Crown lands (no taxes - yet municipal services)
  o National Child Benefit Supplement (municipal share)
  o Gross Receipts Tax
  o Public Health phase-in

We are pleased to see the recent Provincial announcements on the approach to 2006 OMPF funding: the base increase of $51 million dollars will benefit a total of 391 municipalities; and, the extension of the stable funding guarantee will ensure that no municipality will see revenue losses in 2006.

However, without a significant and permanent infusion in funding, OMPF remains neither equitable nor sustainable. The reissue of a one-time funding guarantee in 2006 is a signal that the OMPF formula is not yet right.

\textsuperscript{16} Ambulance funding used to be part of the CRF program and was reconciled each year subject to arbitrary decisions on the part of the Province as to what costs they would reconcile. For example, the province will only pay 50% of 2% annual increase in wages, or 1%. Many arbitrated settlements and those attained through collective bargaining exceeded 2%. As a result municipalities pick up a disproportionate share of salary and benefit costs. This is important when approximately 80% of all ambulance costs are wages and benefits.
CONCLUSIONS

Municipalities play a large part in building strong, productive and competitive communities across Ontario. Yet, growing responsibilities and shrinking resources are stifling our cities and communities, large and small. A key priority must be to ensure that our communities function well and have the capacity to be their best in which to live and work.

Yet, Municipal governments have been faced with trying to provide high quality programs and services to their residents at a time when costs have been rising far quicker than revenues. Financing them and meeting our capital needs is putting the health and safety of our communities in a precarious predicament - more so than at any other time.

We are not asking for special treatment. We are asking for the provincial government to narrow the gap between what municipalities spend on Provincial health and social services programs and the funding we get in return. The OMPF, like its predecessor the Community Reinvestment Fund, still perpetuates this burden. Ultimately, the Province must reduce its reliance on the municipal property tax base to pay for these services and income redistribution programs.

Continued municipal financing of these provincial health and social programs and services alongside responsibilities for routine construction, maintenance and operation of a spectrum of services (e.g., water and sewer services, transit and transportation, cultural and recreational centres and parks) not to mention an annualized deferred maintenance and delayed infrastructure investment deficit is an unsustainable burden on the municipal sector and a key driver of property tax escalation.

With Ontario’s municipalities facing the highest municipal property taxes in the country, the property tax base is overburdened. Not only should the $3 billion dollar gap be addressed, but also municipalities should be given a share of the
dynamic income and consumption tax revenue that the Province uses to address its fiscal commitments. Municipalities must be able to depend on a fair and sustainable financial network that matches appropriate revenue streams to the true cost of services municipalities are mandated to provide to their communities.

This government delivered a multi-year health care Budget in 2004 and a multi-year education Budget in 2005. In 2006, Ontarians need a multi-year municipal Budget that recognizes the needs of communities. Failure to do so will condemn Ontario communities to the status quo for many years to come.

As long as the province relies on municipal property taxes to subsidize these programs, Ontario’s Budget can never be “balanced” in the true sense of the word. Ask yourself this question: “Will the provincial budget ever truly be balanced as long as the province relies on municipal revenues to fund provincial services?”

AMO is urging this Committee and all Ontario MPPs to seize the following three priorities in this year’s Budget:

• Provide an immediate and meaningful reduction in the cost to municipalities to subsidize Provincial health and social services programs, with a view to its eventual elimination;

• Commit to ensuring that predictable and sustainable revenue is available to all municipalities; and,

• Commit to providing a plan to eliminate the municipal infrastructure deficit over time.

We believe that the challenge is to work together to strengthen our communities. The municipal sector has done its part - the provincial government must now lead
the way with a plan for a predictable, sustainable commitment for funding to ensure a prosperous and dynamic province.

We have no illusions that all these changes can occur overnight, but we do know that change must come - and the province has a responsibility to begin planning for change as soon as possible. And we are ready to help.

At a minimum, the Province should commit to upload cost-sharing tied to the $3 billion dollar subsidy for health and social services programs - a minimum of $600 million dollars a year until the full subsidy is eliminated. Furthermore, the Province must work toward addressing other cost-sharing tensions that contribute to the municipal fiscal imbalance - including the failure of the Provincial government to provide its 50% share of land ambulance costs.

Continued provincial expansion in telecommunications infrastructure, such as the expansion of broadband Internet service across many small communities in the North, would make it easier to develop new ventures in fields such as e-commerce, distance education and tele-medicine. This kind of technology would support the creation of new job opportunities in emerging technologies, promise new economic sectors in their communities, and would be advantageous to our existing industrial sectors across Northern Ontario.

Ontarians now have a government in Ottawa that recognizes the fiscal imbalance that has left provinces, territories and municipalities short. AMO and its member Municipal governments are calling on the Minister of Finance to demonstrate Ontario’s leadership in this important matter of national interest by committing to address the provincial-municipal fiscal imbalance here in Ontario.

The time is now.
APPENDICES
## APPENDIX A: Summary of Municipal Net Expenditures in Health and Social Services

### 2003 PROVINCIAL SUMMARY

<table>
<thead>
<tr>
<th>Lineid</th>
<th>Services</th>
<th>Total Expenditures</th>
<th>Less Unfunded Liabilities</th>
<th>Ontario Conditional Grants</th>
<th>Canada Conditional Grants</th>
<th>Other Municipalities</th>
<th>User Fees and Service Charges</th>
<th>Net Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>1010</td>
<td>Public Health Services</td>
<td>566,222,323</td>
<td>278,565,194</td>
<td>907,637</td>
<td>6,609,354</td>
<td>13,765,037</td>
<td>266,375,101</td>
<td></td>
</tr>
<tr>
<td>1030</td>
<td>Ambulance services</td>
<td>593,450,315</td>
<td>237,508,667</td>
<td>-209,198</td>
<td>42,173,144</td>
<td>1,236,805</td>
<td>312,740,897</td>
<td></td>
</tr>
<tr>
<td>1210</td>
<td>General Assistance</td>
<td>3,698,173,073</td>
<td>2,097,425,817</td>
<td>45,769,482</td>
<td>209,901,711</td>
<td>14,158,729</td>
<td>1,330,917,334</td>
<td></td>
</tr>
<tr>
<td>1220</td>
<td>Assistance to Aged Persons</td>
<td>1,014,452,767</td>
<td>497,187,288</td>
<td>188,813</td>
<td>4,757,063</td>
<td>269,832,630</td>
<td>242,486,973</td>
<td></td>
</tr>
<tr>
<td>1230</td>
<td>Child Care</td>
<td>743,457,295</td>
<td>495,252,266</td>
<td>830,681</td>
<td>7,777,043</td>
<td>46,221,553</td>
<td>193,375,752</td>
<td></td>
</tr>
<tr>
<td>1499</td>
<td>Social Housing</td>
<td>1,600,618,315</td>
<td>108,075,592</td>
<td>320,534,345</td>
<td>99,598,130</td>
<td>192,697,771</td>
<td>879,712,477</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Subtotal</td>
<td>8,216,374,088</td>
<td>3,714,014,824</td>
<td>368,021,760</td>
<td>370,816,445</td>
<td>537,912,525</td>
<td>3,225,608,534</td>
<td></td>
</tr>
</tbody>
</table>

Source: 2003 Financial Information Returns

* Figures net of provincial and federal contributions, use fees and service charges
### APPENDIX B: Municipal Spending Differences between Ontario and the Rest of Canada

<table>
<thead>
<tr>
<th>Program</th>
<th>Ontario ($per capita)</th>
<th>Rest of Canada ($per capita)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social Services</td>
<td>$412 (25.2%)</td>
<td>$13 (1.2%)</td>
</tr>
<tr>
<td>Housing</td>
<td>$116 (7.1%)</td>
<td>$19 (1.7%)</td>
</tr>
<tr>
<td>Health</td>
<td>$89 (5.4%)</td>
<td>$9 (0.8%)</td>
</tr>
</tbody>
</table>

If Ontario municipalities spent the same per capita Rest of Canada, municipal overall spending would fall by:

- $1.8 billion for social services
- $800 million for social housing
- $430 million for health care
- $3 billion annually

*Source: Harry Kitchen, August 16, 2005*
## LSR Impact on 2005 Budget

<table>
<thead>
<tr>
<th>Ref</th>
<th>Description</th>
<th>City</th>
<th>2004 Budget</th>
<th>2005 Budget</th>
<th>$ Change</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>C1</td>
<td>C2</td>
<td>C3</td>
<td>C4</td>
<td>C5</td>
</tr>
<tr>
<td>1</td>
<td>Total City Budget</td>
<td>143,858,545</td>
<td>81,228,000</td>
<td>163,080,681</td>
<td>92,045,041</td>
<td>16,224,138</td>
</tr>
<tr>
<td>2</td>
<td>Social Services</td>
<td>45,558,809</td>
<td>13,651,285</td>
<td>50,448,082</td>
<td>15,476,469</td>
<td>4,880,273</td>
</tr>
<tr>
<td>3</td>
<td>Housing</td>
<td>8,504,511</td>
<td>3,964,077</td>
<td>8,495,099</td>
<td>3,846,030</td>
<td>990,952</td>
</tr>
<tr>
<td>4</td>
<td>Provincial Offence</td>
<td>(7,308,887)</td>
<td>(373,804)</td>
<td>(927,453)</td>
<td>(440,135)</td>
<td>(157,360)</td>
</tr>
<tr>
<td>5</td>
<td>Land Ambulance</td>
<td>2,169,595</td>
<td>2,244,927</td>
<td>0</td>
<td>7,872</td>
<td>(23,352)</td>
</tr>
<tr>
<td>6</td>
<td>Health Unit</td>
<td>1,024,200</td>
<td>1,247,033</td>
<td>0</td>
<td>23,352</td>
<td>2.7%</td>
</tr>
<tr>
<td>7</td>
<td>MPAC</td>
<td>711,574</td>
<td>711,574</td>
<td>730,851</td>
<td>730,851</td>
<td>19,277</td>
</tr>
</tbody>
</table>

**Total** 54,615,067 21,058,379 55,746,545 23,540,514 5,731,556 2,564,144 10.6% 11.0%

| 8   | LSR as % of total    | 37.6%      | 25.0%      | 38.6%      | 25.6%      |          |          |

Gross costs have increased by $5.7 Million (10.6%), and the City’s net costs have risen by $2.5 million or 11.9% or ($1.7 million).