The Ontario Alternative Budget 2001

Toronto's revenue crisis: A made at Queen's Park problem that's only going to get worse

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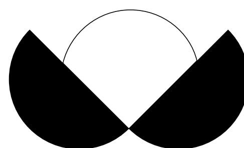

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Toronto's fiscal squeeze in a nutshell

The City of Toronto is well into its second consecutive crisis budget cycle, and there is no shortage of solutions to be put forward, from the creative (earmarking fuel taxes for transit) to the self-serving (living within our [drastically reduced] means). But because most of the solutions focus on things the City itself can control, every last one of them misses the point.

If the stark choices between massive and destructive cuts in services and substantial increases in residential property taxes leaves you angry and frustrated, you have a choice: get used to it; or get on the subway up to Queen's Park. Because Toronto's budget problems are a direct result of deliberate policy decisions by Mike Harris and his friends Ernie Eves and Jim Flaherty, and the situation is only going to get worse – much worse.

Thanks to restrictions in City tax policies brought in by Ernie Eves and toughened up last year by Jim Flaherty, Toronto has effectively lost access to 63% of its tax base for increased service costs. Those restrictions prevent Ontario municipalities from increasing tax rates on any property class that pays taxes, relative to residential taxes, that are higher than the provincial average.

For Toronto, with higher taxes on multiple residential, commercial and industrial property than the provincial average, that adds up to a provincial freeze on nearly two thirds of its tax base – a freeze could last for more than twenty years.

Unless the Province changes its tune, there will be no relief from the freeze until residential property tax rates in the City have more than tripled.

The provincial freeze of property taxes on owners of multiple residential, commercial and industrial property is the reason why, in the debate over the City budget, we are being told that residential taxes have to go up by 4.8% to generate an overall average tax increase of 1.7%.

What is Bill 140, and why does it matter?

Here's how the problem is created. Under Bill 140, the Harris Government's most recent municipal finance "reform" bill, the government establishes rules for the relationship between tax rates on different classes of property in Ontario municipalities.

The regulations under Bill 140:

- Define the "tax ratio" of a property class as the ratio of the tax rate on that class of property to the tax rate on residential property;
- Establish standards for commercial, industrial and multiple residential tax rates that limit tax ratios to no more that 1.1:1 – i.e. limit rates on these property classes to no more than 10% more than residential tax rates;
- Prevent municipalities from adopting tax policies that increase the tax ratio of any

class of property, if the effect of the policy would be to push the ratio above the mandated ratio;

- Establish interim rules that limit the current ratios of commercial, industrial and multiple residential tax rates to residential tax rates to the respective provincial average; and
- Prevent municipalities from increasing the rates of tax on any class of property for which the tax ratio is greater than the provincial average.

The key ratios as they affect Toronto are summarized in Table 1.

The regulations affect municipal finances in different ways, depending on their current tax ratios. If a tax ratio for a particular class of property in a municipality is higher than the provincial average tax ratio, there can be no increase in tax on that class of property. For example, because the tax ratio for commercial property in Toronto is 3.798 compared with the provincial average of 1.98, Toronto cannot increase its tax rates on commercial property.

If the tax ratio for a particular class of property is between 1.1 and the provincial average, the municipality can increase its tax rates on that class of property, as long as the tax ratio does not increase. For example, a municipality whose commercial tax ratio is between 1.1 and 1.98 is permitted to increase its commercial tax rate, as long as the increase is not greater than the increase on residential property.

If the tax ratio is in the permitted band of 1.0 to 1.1, there is no restriction on tax policy.

And if the tax ratio is below 1.0, the ratio cannot be reduced.

The impact on Toronto

For the City's budget, the arithmetic is brutal. Let's look at what has to happen to generate a modest 2% increase in the City's overall budget, just to keep up with inflation. The City's revenue comes from three main sources: property taxes (44%); user charges of various kinds (22%); and grants from the provincial and federal governments (21%). Another 12% comes from "other" sources[1].

Even if you assume that all revenue sources other than property taxes – including the City's user fees[2] — will keep up with inflation, residential property taxes would have to go up by 5.4% under these provincial rules.

If federal and provincial grants don't keep up with cost increases, the result is even worse. A 2% increase in service costs would translate into an 8.1% increase in residential property taxes, even with user charges matching inflation.

Table 1

Class	Actual Current	Provincial Average	Standard
Multiple-residential	4.174	2.74	1.0 to 1.1
Commercial	3.798	1.98	1.0 to 1.1
Industrial	5.301	2.63	1.0 to 1.1

If this situation were the only unusual the only unusual stress point in the budget and a one-time-only event, there might be a short-term fix to be found in creative use of the City's reserve funds and capital financing strategies. Unfortunately, neither is the case.

The City's budget is already under stress in three areas.

First, it has yet to absorb the full consequences of the unbalanced download of financial responsibilities from the Provincial Government in its provincial municipal financial restructuring. Whether the correct number is $140 million (as identified by the Provincial Auditor, not including transit capital) or $276 million (as calculated by the City, including transit), Toronto took a substantial hit from the Province in the restructuring process. That's equivalent, in property tax terms, to an overall property tax increase of 5%, or 13.5% applied only to residential property.

Second, because of the need to deliver on mayoral candidate Lastman's promise of no tax increases in his first term of office, the City came into the 2001 budget cycle having more than used up any flexibility it might have had in its budget. By artificially holding back needed revenue increases, the City created a backlog of unmet needs and self-imposed financing difficulties. Assuming costs were going up at 2% a year during that period, equates to a property tax increase of 6.1% overall and 16.5% applied, under provincial restrictions, to residential property alone.

Third, when the City faced exactly the same tax base access problem last year, it decided to hide its impact yet again through service cuts and creative financing.

So the City goes into this budget cycle in a very deep fiscal hole.

Worse still, the tax base squeeze will continue for some time, unless something happens at Queen's Park to bring its attack on Ontario's big cities to an end. That's because the restriction on taxes paid by owners of multiple residential, commercial and industrial properties will continue to apply to Toronto for years to come.

What does this mean for residential taxpayers?

- Assuming total revenue growth required of 2%, and an annual 5.4% residential tax rate increase, the freeze on commercial, industrial and multiple residential tax rates will last for many years. Just to reach the current average would require a freeze of between 8 and 13 years. To reach the upper limit of the so-called "fairness range" would extend the freeze beyond 20 years for all three of the major non-residential classes.

- Looking at it another way, substantial percentage increases in residential tax rates would have to take effect before Toronto gets access to these restricted property classes for tax increases.

Table 2

YEARS of FREEZE	Current tax ratio standard	"Fairness" ratio
Multiple residential	8 years	25 years
Commercial	12 years	23 years
Industrial	13 years	29 years

Table 3

Percentage increase in residential rates required	Current tax ratio standard	Long-term tax ratio standard
Multiple residential	52%	279%
Commercial	92%	245%
Industrial	102%	382%

- Just to meet the current provincial average, Toronto's rates would have to increase by 50% before multiple residential rates could be touched, and would have to double to permit access to commercial and industrial rate increases.

- Or to look at it another way, commercial tax rates won't increase again until residential rates have increased by 279% (more than 3.5 times their current level). Industrial tax rates won't increase again until residential rates have increased by 382% (more than quadrupled). Multiple residential tax rates will remain frozen until residential rates have increased by 245% (more than triple their current levels).

Is this just a Toronto problem?

This provincial policy has more impact in Toronto than it has in any other part of the province, simply because Toronto has both high tax ratios and a significant proportion of the total commercial, industrial and multiple residential tax base in the province.

However, there are many municipalities today whose tax ratios exceed the provincial average, and are therefore limited in their ability to finance increased local services costs.

Furthermore, as the provincial government phases permitted ratios down to the targeted 1.1 to 1.0 ratios, this restriction will bind the tax policies of new municipalities every year.

Even if the Province sticks to the provincial average ratio as the standard, the effect will be increasingly corrosive. Because Toronto's non-residential tax rates are frozen, its tax ratio will be declining over time. And because Toronto accounts for about 40% of the commercial and industrial tax base in the province and a significant share of the multiple-residential tax base, a decline in Toronto's ratios will drive down the provincial average and push more and more munici-

palities into the range of restricted tax policies.

As a result, the restrictions under Bill 140 will have an increasingly corrosive effect on the budgets of most of the larger urban municipalities in Ontario as the long-term provincial standard is phased in.

What should Toronto and other municipalities affected by Bill 140 be doing?

Clearly, this is not sustainable. The key question facing the municipalities in Ontario today is what to do about it.

If Councils that are affected by Bill 140, as Toronto is, continue to stick with modest, inflation-rate linked property tax increases, they will in effect be mandating a slow, steady long-term erosion in the quality of public services and the quality of life in Toronto and other municipalities across Ontario. And it will put municipalities at an even greater long-term financial risk.

That may give the ideologues in the Provincial Government exactly what they want. But we already know it doesn't make any sense for Toronto, or for any other municipality in the Province.

The only strategy that makes any sense is to force the issue. Establish a budget that meets local needs and that would require only normal tax increases with access to a full tax base. Increase residential taxes by enough to support the budget. And explain why — clearly, concisely and repeatedly.

Endnotes

1. City of Toronto 2000 Audited Financial Statements
2. Transit Fares, Water Rates, Fines, Licences and Permits, Fees and Service Charges