DOCUMENT 1

LRFP IV (Part 1)

Introduction

The City of Ottawa is committed to producing updated long-range financial plans at the beginning of each term of Council or whenever there is a significant change in a source of funding that requires adjustment to the current plan. The development and receipt of these plans in the past has proved beneficial as they:

- provide an understanding of the City's financial condition,
- provide the framework for development of the yearly budgets, and
- identify strategies that can be pursued to reduce any funding gaps and increase financial sustainability.

A review of previous plans shows that their delineation has increased over time, as sources of funding are assessed against the needs they are dedicated towards. A review also shows that the City has been fairly successful in advancing a number of strategies identified in the plans.

1. The City's first Long Range Financial Plan (LRFP) was developed in 2002. That plan dealt solely with capital infrastructure and its importance in ensuring economic prosperity for the region, province and nation and therefore the need for an ongoing commitment from the two upper levels of government to contribute towards their renewal. The capital funding gap identified in the document was $1.6 B for all programs.
2. With the announcements of federal and provincial gas tax contributions, an increased GST rebate and a new development charges by-law the Long Range Financial Plan was updated again in 2004 with a separate report for rate supported capital works. That plan resulted in the establishment of the Endowment fund and the contribution of its earnings towards capital works. LRFP 2 identified a capital gap of $1.2 B for the tax supported programs.
3. The third LRFP the City produced in 2006 further segregated the capital needs by funding and included a needs and funding schedule for Transit and solid waste in addition to City-wide tax supported and rate supported capital works. This plan also forecasted the term of Council operating budget needs. The results of this plan included the special capital levy that was implemented in 2008 and 2009 and in the *Fiscal Framework*, which detailed the City's strategies with respect to all aspects of its financing. LRFP 3 identified a capital funding gap, including strategic initiatives of $1.9 B for tax supported programs and $431 M for rate supported programs.

This will be the fourth long-range financial plan that is being presented to Council. One of the most significant changes since the development of the last LRFP has been the inclusion of tangible capital assets in the financial statements. This work laid the foundation for a more comprehensive assessment of capital renewal needs as it required all capital assets to be identified, valued and a useful life established. From this work staff are developing a state of asset reporting system so that a more rigorous approach can be taken to determine capital renewal needs.

The new Council has already provided some direction with respect to the development of a Long Range Financial Plan. At the December 18, 2010 Council meeting the following motion was adopted.

WHEREAS this Council is committed to promoting a culture of fiscal responsibility at City Hall; and

WHEREAS this Council wishes to proceed with the development of its 2011 Budget as soon as possible; and

WHEREAS budget directions with respect to any taxation target have not yet been provided to either staff or Standing Committees responsible for preparing and reviewing budget submissions; and

WHEREAS City Council's first budget will set the pace and tone for all four budgets we will fashion together; and

WHEREAS Council is mindful of the tough choices many of its citizens must make every day in this economy and is prepared to make the same tough choices when deciding how to spend taxpayers' dollars in 2011 and beyond; and

WHEREAS the Long Range Financial Plan that is to be developed after the adoption of the 2011 budget provides a term of Council forecast of the City's financial situation;

THEREFORE BE IT RESOLVED that the 2011 Draft Budget for all of the City's tax-supported programs be prepared on the basis of a maximum 2.5% total tax increase; and

BE IT FURTHER RESOLVED that the Mayor and the City Manager present a budget overview report to Council that details how that tax target objective can be achieved at a Special Meeting on January 19, 2011; and

BE IT FURTHER RESOLVED that City Council direct each Standing Committee to work within the funding envelope for the budgets in their mandates, and that any additions to the budget will require offsetting reductions; and

BE IT FURTHER RESOLVED that City Council request the Ottawa Police Services Board and the Ottawa Public Library Board deliver budgets that would have no more than 2.5% increase on their tax requirement; and
BE IT FURTHER RESOLVED that the Long Range Financial Plan be developed with a maximum tax increase of 2.5% for the years 2012 to 2014.

This plan will be presented in four sections, reflecting the unique capital needs and dedicated funding sources in the City. The first section of the LRFP in this report deals with the 2012 to 2014 operating budget forecast and the strategy to stay within the 2.5% tax target over the term of Council. The capital section of this report only speaks to the funding envelopes for capital strategic initiatives for the term of Council.

The Transit operating and capital long range plan will come forward in conjunction with the reports on the cost of the new Light Rail project and will provide an assessment of the overall Transit affordability for the next 30 years. In the fall the rate (water/sewer) supported long-range plan will come forward as will the long-range capital plan for city-wide funded projects. The last two reports have been delayed in order to benefit from a rigorous internal review of capital needs through the development of a state of asset report and asset management framework. The capital section of this report outlines the work to be undertaken in preparation of the capital LRFP.

Operating Budget – 2012-14 Forecast

Based on Council's direction that the LRFP be developed with a maximum 2.5% increase over the term of Council, an overall strategy has been developed for Committee and Council consideration which is summarized in Table 1 below.

Table 1

2012 - 2014 Budget Strategy

	2012	2013	2014
Assessment Growth - 2.00%	**(24,706)**	**(25,818)**	**(26,979)**
Tax Increase - 2.5%	**(30,882)**	**(32,272)**	**(33,724)**
Reduction In PIL Revenues	**-**	**-**	**5,000**
	(55,588)	(58,090)	(55,703)
Target Allocation			
Police	(9,450)	(9,875)	(9,470)
Public Health	(500)	(523)	(501)
Library	(1,668)	(1,743)	(1,671)
Transit	(9,450)	(9,875)	(9,470)
	(21,068)	(22,016)	(21,111)
Balance Available to City Operations	**(34,520)**	**(36,074)**	**(34,592)**
Allocations for:			
Provincial Uploads	(2,635)	(5,135)	(5,010)
Service Ottawa Savings	(7,559)	(8,459)	(3,950)
Revenue Growth	(3,000)	(3,000)	(3,000)
	(13,194)	(16,594)	(11,960)
City Operations Target	**(47,714)**	**(52,668)**	**(46,552)**

Maintain & Growth Envelope	45,079	47,533	41,542
Strategic Initiatives Envelope	2,635	5,135	5,010
Total Envelope	**47,714**	**52,668**	**46,552**

To set the overall funding framework, a forecast of additional tax revenues derived from the 2.5% increase was developed. To this was added the projected additional 2% of tax revenues from assessment growth based on a review of the trend in assessment growth since amalgamation. Table 2 provides a history of assessment growth increases covering the period from 2001 to 2011

Table 2

Assessment Growth – 2001-2011

Year	Growth
2001	4.3%
2002	3.5%
2003	3.0%
2004	2.5%
2005	2.5%
2006	2.5%
2007	2.2%
2008	1.8%
2009	2.0%
2010	1.6%
2011	1.9%
Average	**2.5%**

Under these assumptions, taxation revenues would be projected to increase in 2012 by $55.6 million, $58.1 million in 2013 and by $60.7 million in 2014. However, in 2014 the City is expected to lose approximately $5 million in Payment-in-lieu of taxation revenues as a result of the Province's decision to reduce business education taxes. Education taxes on PIL properties are retained by municipalities to offset the costs of providing City services so therefore a reduction to provincially determined education tax rate will result in lost revenues to the City.

With the funding framework proposed, each of the City services governed by either a Board or Commission, namely Police, Public Health, Library and Transit services, would be allocated a proportionate share of this projected increase in taxation revenues based on their net taxation requirements. The remaining balance would be available to fund all other tax supported City services.

This balance would be further augmented to arrive at an overall City Operations Target as a result of:

- The continuing uploading of Ontario Works (OW) costs (from 2010 to 2018);
  As a result of the Provincial-Municipal Fiscal and Service Delivery Review agreement signed on October 31, 2008 the Province agreed to upload the cost of all social assistance benefits by 2018 and pay the portion of Ontario Works benefits currently paid by municipalities. Prior to 2010, the Province paid approximately 80 per cent of Ontario Works benefits and the municipalities 20 per cent. This 20 per cent municipal share will be reduced according to the chart below and is projected to save the City $30 million by 2018. In the meantime the Province has announced yearly OW rate increases of 2% per year, which results in the City costs for this program increasing before the Province fully assumes it.

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
OW Benefits	**-**	**3%**	**6%**	**14%**	**29%**	**43%**	**57%**	**71%**	**86%**	**100%**

- Efficiency savings from the implementation of Service Ottawa initiatives;
  Efficiency targets resulting from the Service Ottawa initiatives are built into each year's budget and if not achieved in the year are carried forward. The efficiency savings are available within the departments that generate them to offset costs pressures in the department.

- Projected revenue growth from increases in various fees and charges.
  Revenue assumptions included are:
    - No recreation fee increases for youth programs
    - Garbage fee decreases as the service is moved to bi-weekly
    - General rate of inflation on other fees and charges
    - General growth in fees as a result of increased usage.

It is proposed that the annual taxation capacity created by the Provincial uploading be utilized to create a funding envelope to address any new needs or strategic initiatives that Council may wish to pursue as a result of setting its term of Council priorities. These funds would be in addition to the strategic initiative funds that have already been established in the 2011 base operating base as outlined in Table 3. Council could choose to realign some of the funds allocated to 2011 initiatives and shown as on-going in future years towards new initiatives.

Table 3

2012-2014 Strategic Initiatives Strategy (Operating)

Operating - Strategic Initiatives	2011	2012	2013	2014
Public Health – Suicide Prevention & Brain Injury	450	450	450	450
Senior & Veterans Free Transit Service	1,400	1,400	1,400	1,400
Transit Service Reliability	1,116	1,116	1,116	1,116
Sub-total Boards and Commissions	**2,966**	**2,966**	**2,966**	**2,966**
Housing	10,000	10,000	10,000	10,000
Recreational Fee Freeze (net)	600	600	600	600

Forestry	1,543	1,543	1,543	1,543
Economic Development Initiatives	2,000	2,000	2,000	2,000
Community Development	700	700	700	700
To Be Allocated	**-**	**2,635**	**7,770**	**12,780**
Sub-Total City Operations	**14,843**	**17,478**	**22,613**	**27,623**
TOTAL	**17,809**	**20,444**	**25,579**	**30,589**

With the upload allocated towards strategic initiatives the remaining balance of the City Operations target would be available as a ”Maintain / Growth” envelope to address budgetary expenditure and revenue pressures to maintain City services at current Council approved standards along with funding growth pressures.

With this proposed strategy, the key question is whether this envelope will be sufficient to fund costs to maintain services and to address growth pressures over the 2012-14 time period.

In order to determine this staff have developed operating budget forecasts for 2012-14. An assessment of the various projected expenditure and revenue pressures, along with opportunities and risks that are likely to be encountered during this period has been prepared based on the best available information at this time.

Cost increases to maintain services have been estimated using the assumptions as presented in the Table 4. These include the major cost drivers in the provision of City services – compensation and benefits, including the announced premium increase in OMERS rates, energy, case load, inflation, contributions to capital reserve funds etc.

Table 4

2012-2014 Assumptions

	2012	2013	2014
COLA + Benefits	2.0% - 3.0%	2.0% – 3.0%	2.0% – 3.0%
OMERS premium increase	1.00%	0.90%	-
General Inflation	2.0% – 3.0%	2.0% - 3.0%	2.0% - 3.0%
Hydro Increase	7.0% - 9.0%	5.0% - 7.0%	5.0% - 7.0%
Fleet Reserve contributions	5.00%	5.00%	5.00%
City Wide Reserve contributions – Construction Price Index	2.90%	2.90%	2.90%
Fleet Parts and Repairs	5%	5%	5%
Fuel	10%	10%	10%
Ontario Works Rate Increase	2.00%	2.00%	2.00%
Ontario Works Caseload Increase	2.50%	2.50%	2.50%

An estimate of growth pressures has been developed based on a review of historical information to develop a range for 2012-2014. In addition increases in debt servicing costs have been estimated based on current and projected debt issues required to finance Council approved capital works with debt authority.

By utilizing the above assumptions, staff have developed possible budgetary pressure scenarios ranging from the low end (best case) to the high end (worse case). This matrix of possible outcomes has been summarized in Table 5 in order to provide Committee and Council with a sense of the magnitude of budgetary pressures that could face the City in the next 3 years.

Table 5

2012 - 2014 Forecast - Budget Strategy

	2011	2012		2013		2014	
Budgetary Pressures	Base	Low	High	Low	High	Low	High
Maintain	**1,578,518**	**31,000**	**44,000**	**32,000**	**45,000**	**32,000**	**47,000**
Growth	**12,941**	**10,000**	**16,000**	**13,000**	**18,000**	**8,000**	**16,000**
Combined Total Range		**41,000**	**60,000**	**45,000**	**63,000**	**40,000**	**63,000**
Maintain / Growth Envelope		**47,714**		**52,668**		**46,552**	

Excludes - Police, Library, Public Health & Transit

As can be seen from this table, the "Maintain / Growth" envelope falls within the projected high / low cost range for maintain and growth pressures. Although this would imply that this envelop should be sufficient to fund the projected pressures and enable Council to stay within its desired tax increase target, it must be recognized that the envelope is at the lower end of the range. Increased costs for growth is limited and may result in some decline in service levels standards. The investment in Service Ottawa may allow some of these service declines to be offset by increased productivity;

Should economic conditions change and increases for major cost items such as compensation, energy and caseload, exceed the best case scenario, it could create a significant challenge to maintain the tax increase target.

In order to maximize Council's ability to achieve its stated taxation direction and to minimize potential risk factors, staff are recommending the following in the establishment of the 2012-14 draft budget estimates.

1. Boards and commissions be directed to stay within their allocated budget targets;
2. Strategic initiatives be limited to the amount of tax room made available from any upload and are determined through the priority setting process currently under way;
3. The non-discretionary costs associated with the maintenance of existing city services should be considered first in terms of funding priorities;
4. The budget development process should be lead by the City Manager and the Mayor's office and as in 2011, a report should be tabled as part of budget tabling that would describe any strategies that needed to be implemented in order to stay within the tax target;
5. In some areas, more risk may be taken in developing the budget knowing that there are reserve funds, such as the Winter Maintenance Reserve, to smooth fluctuations in expenditures where necessary;
6. The budget would not include any one-time sources of revenue unless they are to fund expenditures that are also of a one-time nature;

7. Approach the Province to provide a solution for the loss of PILT revenue in 2014.

Capital

The City of Ottawa is the steward of public assets valued on a historical cost basis at $14 Billion. On a replacement value basis these assets would cost approximately $30 B for the City to replace today. The inventory of City continues to increase as the City continues to grow. In 2010 the City purchased, constructed or had contributed by developers $1.1 B of assets. The annual operating costs for the repair of these assets and for the programming associated with the assets, are included in the operating budget. The regular renewal of these assets forms part of the capital budget. The following table shows the acquisition value and accumulated depreciation (amortization) by asset type as at Dec 31, 2010.

Table 6

Tangible Capital Assets

Asset Type	Acquisition value $'000	Accumulated Depreciation $'000	Net Book Value $'000
Buildings	1,670,588	595,315	1,075,273
Roads	2,515,857	1,069,774	1,446,083
Water/wastewater	4,199,506	1,025,592	3,173,914
Land	2,628,570		2,628,570
Land Improvement	496,855	151,589	345,266
Machinery, Plant, Equipment	1,113,265	363,131	750,134
Vehicles	837,976	259,147	578,829
Assets Under Construction	877,168		877,168
TOTAL	14,339,785	3,464,548	10,875,237

Like all other Canadian cities, Ottawa has never had the resources to spend at the level of renewal that a simple analysis would suggest. As the assets depreciate by just over $200 M per year on a historical cost basis, moving that to a current replacement basis would suggest that $600 M should be spent per year. This type of analysis assumes assets were added on an equal basis each year, when it fact growth in the asset base is not constant. The analysis also assumes all assets are replaced at the end of their useful life established through the Tangible Capital Asset accounting policies. Reality has shown that some assets need to be replaced well in advance, whereas others exceed their life expectancy.
Funding of Capital Strategic Initiatives

Council is currently establishing their term of Council priorities, some of which may require capital investment. This category of capital investment, which is neither works associated with growth or the renewal of existing assets, has had an annual $34 M envelope of funds created for the term of Council.

The tax funding allocated to strategic initiatives in the 2011 capital budget was approximately $34 million as shown below. For 2012 to 2014; the budget document had identified a similar envelope and indicated projects that would be funded from the envelope, with some funds remaining uncommitted.

Given the funding for renewal and capital growth needs, as identified in prior LRFP reviews, it is prudent that the annual capital budget envelope for Council's Strategic Initiatives be limited to the $34 million envelope as identified in the 2011 capital budget.

The following table shows the capital initiatives already identified and remaining uncommitted balance for the next three years. The amounts shown as pre-committed are all subject to Council approval through the budget process.

Table 6

Capital budget envelope for Council's Strategic Initiatives

Capital – Strategic Initiatives	Forecast in 2011 Budget $000		
Budget Year	**2012**	**2013**	**2014**
Service Ottawa	15,000	14,908	14,036
Accessibility	2,000	2,000	2,000
Housing	4,000	4,000	4,000
Parks & Recreation Facilities Upgrades	1,000	1,000	1,000
Cycling	2,000	2,000	2,000
TMIP - Richmond Road	250	300	350
Child Care Capital Grants	750	750	750
Environmental Management Envelope	500	500	500
Animal Shelter	100	100	250
Trees & Forests Program	170	-	-
Fire - Nederman Exhaust System	100	-	-
Unallocated / Balance	8,330	8,742	9,464
TOTAL	34,200	34,300	34,350

It is important to note that these strategic initiatives relate to tax supported services but excludes Transit along with Water and Sewer related initiatives that are rate supported. Both of these service areas have their own respective reserve funds from which to fund any initiatives that Council may establish as a priority during its term of office.

The Corporate Asset Management Framework and SOAR

As stated previously, both the rate supported long-range plan, and the long-range capital plan for city-wide funded projects, will come forward later in the year. The last two reports have been delayed in order to benefit from a rigorous internal review of capital needs through the development of a state of asset report and asset management framework.

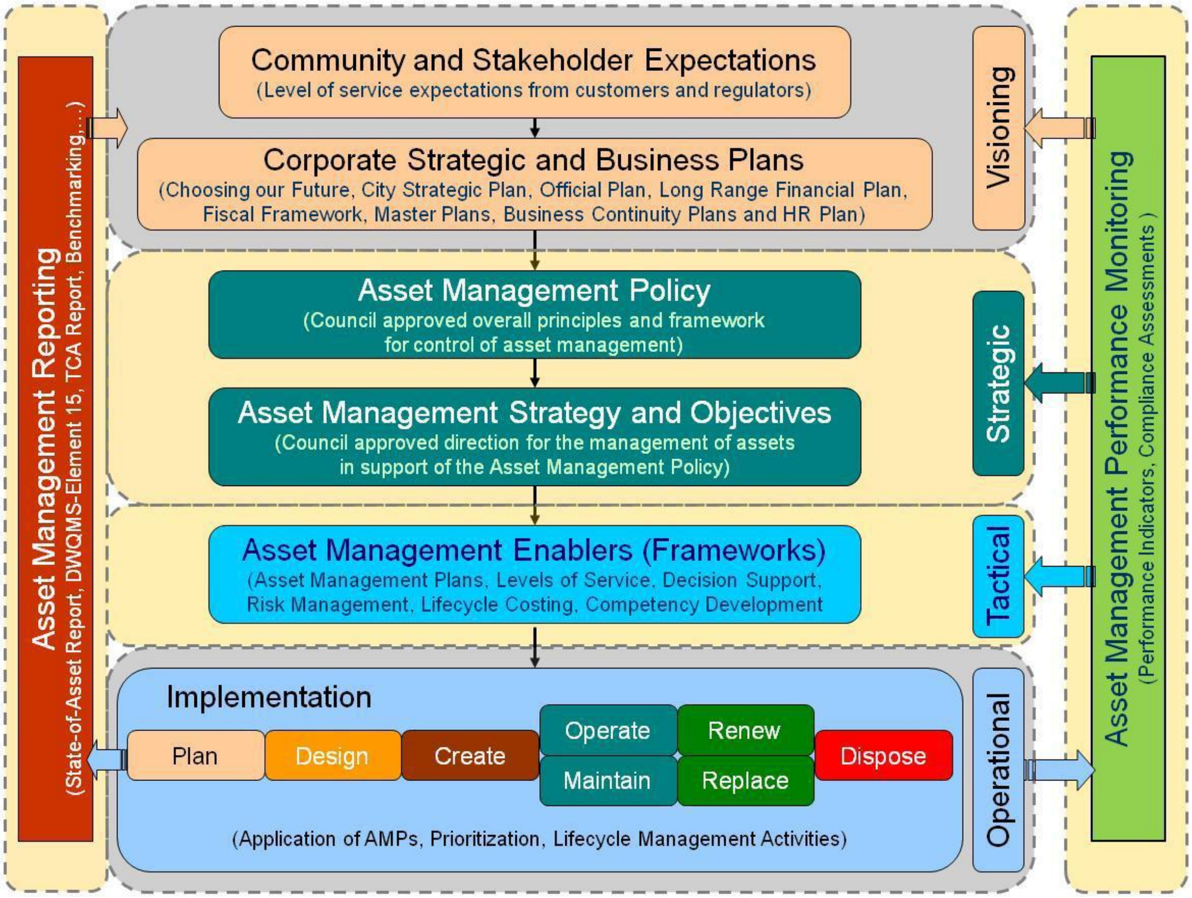
The Infrastructure Services Department, in partnership with city departments, is currently undertaking a multi faceted review of the City's Asset Management Framework. Included in that work is a first step to prepare a State-of-the-Asset report (SOAR) that will inform our spending and servicing needs with respect to the City's capital assets.

This work will give us the opportunity to discuss our capital maintenance needs in the context of service levels; cost and affordability.

This work is currently underway and it is anticipated that some of the elements of this review will be available for Q3 of 2011. Part 2 of the LRFP IV will include the results of this preliminary review.

The intent of the Asset Management Framework work presently being undertaken is to provide an overall framework where the efforts and knowledge gained can be leveraged across the organization, to demonstrate how investment decisions are linked to corporate priorities and to provide consistency in terms of asset reporting.

The following figure provides a draft of the overall asset management framework that shows the connection between key elements.



For 2011, the proposed priorities are:

To formalize a governance structure that supports the management of the City's assets.
The objective will be to develop a governance structure that provides oversight for 2-key element: the development of specific asset management initiatives which tend to be project specific with clear deliverables and timeliness, and the application of these asset management initiatives by the business units which is intended to be an ongoing process.

To produce key deliverables that will promote awareness and consistency. These include:

Asset Management (AM) Policy: this is intended to be a Council approved document that will define key policy statements and set expectations as to how assets are to be managed. It will also provide context on what information will be provided to assist in making infrastructure investment decisions.

State-of-the-Asset Report (SOAR): this is intended to be a fact-based document that provides the current state of the City's assets and an indication of sustainability based on projected investment levels. The intent is to present this document to Council as it will complement the financial information provided in the LRFP.

Asset Management (AM) Strategy: this document is intended to build on the expectations set in the AM Policy and the understanding of the state of assets in SOAR to set the future direction to achieve sustainability.

Asset Management Plan (AMP) framework: the intent is to develop a framework for AMPs so that these can then be developed in a consistent manner across services (i.e. water service, wastewater service, transportation service, etc). The AMPs will be structured to answer the following questions:
1. What we own?
2. What is it worth?
3. What is its condition and expected remaining service life?
4. What is the level of service expectation?
5. What needs to be done and when does it need to be done?
6. How much will it cost and what is the acceptable level of risk?
7. How do we ensure long-term sustainability?