

# BETTER BUDGETS:

## Bolstering the Fiscal Resilience of Ontario's Municipalities

Ashley Challinor

Reid McKay

Claudia Dessanti



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# Summary of Recommendations



## TAXES & FEES

1. The Government of Ontario should undertake a comprehensive and forward-looking review of Ontario's property tax system.
2. The Government of Ontario should extend the postponement of property tax assessments until a more equitable and efficient property tax regime can be established.
3. Ideally, the Government of Ontario should eliminate provincial non-residential property taxes.
4. The Government of Ontario and municipalities should re-consider the use of the highest and best use (HABU) approach to property tax assessments.
5. Municipal governments should improve property tax predictability for businesses. Some options include providing more frequent property assessments, expediting property assessment appeals processes, or partially indexing property tax rates to a benchmark such as inflation.
6. Municipal governments should review their existing catalogue of user fees, permits, licenses, and fines to consider how it can be adjusted to reflect changes in demand.
7. The Government of Ontario should implement an official rate change process to prevent municipalities from increasing or decreasing the Municipal Accommodation Tax (MAT) at their own discretion and establish clear, robust, and enforceable rules to clarify how municipalities may use MAT funds.

## INTERGOVERNMENTAL TRANSFERS



8. The Governments of Ontario and Canada should support communities with new provincial and federal transfers directed towards non-residential tax base relief funds.
9. The Government of Ontario should ensure it is not adding fiscal pressure to municipalities when they can least afford it. This could be achieved by:
  - a. Commissioning an independent review of all municipal responsibilities to assess, in terms of absolute cost and service delivery, whether residents and taxpayers are better served by these responsibilities residing with the federal, provincial, or municipal governments.
  - b. Accompanying all transfers of responsibilities with sustained funding adequate to service delivery needs.
  - c. Consulting with municipal governments and the business community before embarking on provincial services reviews or cuts that would impact municipal government services.
10. The Government of Ontario should adhere to the 'pay-for-say principle', which dictates that if an order of government has input into the operation of a service, it has a corresponding responsibility to fund that service.

## AUTONOMY & GOVERNANCE



11. Municipal governments should issue modified accrual budgets at year-end.
12. The Government of Ontario should reform the interest arbitration system for police services to:
  - (i) reflect municipalities' capacity to pay for increased service costs, (ii) shorten arbitration timelines, and (iii) require written decisions.
13. The Government of Ontario should formalize its Municipal Modernization Program and Audit and Accountability Fund as permanent programs and establish an Auditor General for Local Governance to assist municipalities in delivering the best value-for-money for their residents.
14. The Government of Ontario should support voluntary co-operation between municipalities by identifying potential areas of alignment, developing incentives, championing partnerships that have worked well, and informing municipal governments of how they might collaborate better.



# Introduction

Ontario's municipalities are caught between a rock and a hard place. The COVID-19 pandemic has proven to be a startling awakening to both large segments of the economy and all levels of government. Just as COVID-19's impact has had disproportionate effects on multiple sectors of the economy, the impact on all three levels of government has been unique as well, with municipalities arguably experiencing the greatest hardship.

In Canada, municipalities are referred to as 'creatures of the provinces', meaning they reside under those governments' direct purview. In Ontario, all 444 municipalities except the City of Toronto are governed by the *Municipal Act*, which dictates how they can govern themselves and the resources at their disposal to provide value to residents.<sup>1</sup>

The more restricted a government is in its ability to alter fiscal policy in response to changing circumstances, the more vulnerable they are to economic fluctuations. Higher orders of government can alter their direction in response to changing winds as a schooner would to navigate passage through rough waters. They can issue debt, draw on reserve funds or adjust services all in the name of economics stabilization and stimulation. By contrast, local governments have a limited set of options. More akin to a primitive frigate, municipalities must battle with the limited maneuverability provided to them by the Province while managing a variety of services needed to keep their communities afloat.

Unfortunately, the necessary pace of local economic development is currently at odds with the restricted mobility of municipal governments. Long before COVID-19, municipalities' responsibilities and demand for spending had been increasing, but revenue streams remained stagnant. If local economies are to remain limber, local governments must have the ability to dynamically support them as they see fit.

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<sup>1</sup> Given Toronto's size, it has been granted slightly broader powers under the *City of Toronto Act*.



This challenge is now more important than ever. COVID-19 has placed tremendous strain on local government finances. It will be difficult over the coming years for many municipalities will have difficulties making ends meet in 2021. The impact of the virus and the resulting public health measures have meant that most municipalities saw and continue to experience a decline in revenue all while expenditures have risen. While COVID-19 has created a uniquely difficult situation for Ontario's municipalities, it has also exposed existing weaknesses within municipal fiscal governance.

The business community is often pulled in two directions in its interactions with municipalities. It has a vested interest in fiscal sustainability and the ability of a municipality to operate and fund those critical services within a community which contribute to the 'industrial commons' – the foundation of public investments that drive development and growth. When businesses are able to thrive in their communities, they act as investors, job creators, service providers, and community builders. Despite the already lopsided ratio of residential to non-residential taxes, businesses are often the first target when municipalities start looking to raise revenue through higher taxes and fees.

The residential vs. non-residential lens through which most municipalities view their tax base represents not only a frustration to business but, more importantly, a threat to the overall economic ecosystem of communities. Over-reliance on non-residential sources of revenue – including but not limited to an over-reliance on a single industry or large employer - makes for a fragile assessment base. This threatens fiscal sustainability should businesses move or close. The increasing responsibilities of municipalities demand not only a diverse mix within the tax base, but also a balance in revenue sources so residents can live and work in a community for the long-term.

Before the pandemic, Ontario businesses were concerned about municipal fiscal sustainability. Now, as a result of the COVID-19 pandemic, the situation is dire. Both municipalities and business are struggling to cover costs. Against this backdrop, we identify 14 recommendations for both the Province and municipalities, which we believe can bring immediate and long-term relief to communities across Ontario.

# COVID-19 and Municipal Budgets

■ Prior to the pandemic, Ontario municipalities were generally in a strong budget position, recording a total ‘surplus’ of \$7.4 billion in 2018.<sup>i</sup> Their ‘reserves’ totalled \$31.9 billion, including \$1.7 billion earmarked for budget stabilization – for example, mitigating the impact of a recession.<sup>ii</sup>

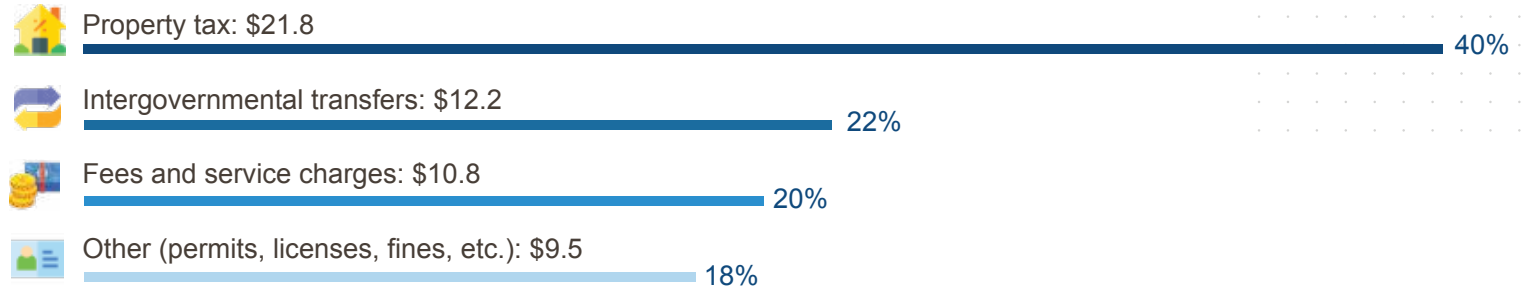
■ Surplus and reserve amounts can be misleading in municipal budgets due to the accounting system used by many local governments in Ontario. For more details, see page 17.

## ONTARIO MUNICIPAL BUDGETS, PRE-COVID<sup>iii</sup>

(in billions)

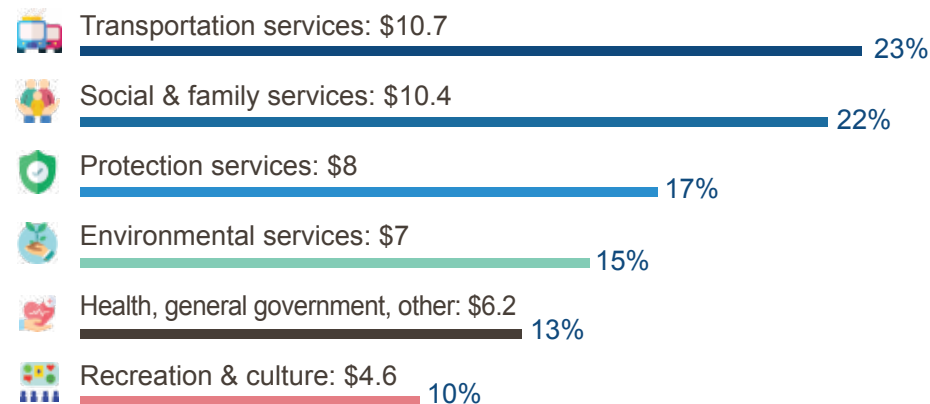
### REVENUE

TOTAL:  
**\$54.3**



### EXPENDITURES

TOTAL:  
**\$46.8**



In the wake of the pandemic, municipalities experienced a contraction in revenue but also worked diligently to curb operational expenses. Based on a recent analysis from the Financial Accountability Office of Ontario (FAO), the expected negative impact on municipal budgets in 2020 is \$4.1 billion. This comes from both a loss in revenue (such as fewer fees collected from transit use, permits, licenses, and recreation/cultural services) as well as an increase in expenditures related to health and human services.<sup>iv</sup> The savings from reduced spending in 2020 are estimated at \$1.1 billion; however, many of those savings cannot be reproduced, as they were captured during lockdowns in which facilities were closed and staff were placed on unpaid leave.<sup>v</sup>

## The bigger they are, the harder they fall

The larger the municipality, the more acutely the pandemic impacted its budget. The City of Toronto experienced a \$1.7 billion gap between its approved 2020 budget and its reality, with an estimated average weekly financial impact of \$65 million.<sup>vi</sup> The City was expected to experience the largest (relative) revenue loss at 10.7 percent for 2020 and 2021. Its neighbours across the Greater Toronto and Hamilton Area, largely within the 750,000 to 1.5 million population group, were expected to see a 7.5 percent loss.<sup>vii</sup> In part, it is these communities' substantial transit networks that are driving this impact, as they have greater reliance on transit fees and higher operational costs than small communities with no or few transit obligations.



Even with cost-saving measures and rainy-day reserves, Ontario's municipalities do not have the revenue capacity to absorb the fiscal impact of the pandemic. That is why the Governments of Ontario and Canada partnered on the Safe Restart Agreement (SRA), which provides up to \$4 billion in support for local governments in the province (including prior announcements of municipal relief funding).<sup>2</sup>

The \$4 billion in pandemic relief for Ontario municipalities was earmarked under four categories:<sup>3</sup>

Municipal transit agencies:

**\$2 billion**

Social services, including homelessness programs and food banks:

**\$0.5 billion**

General operating pressures:

**\$1.4 billion**

Public health services:

**\$0.1 billion**

The FAO estimates that, between municipal cost-saving measures and the SRA, local governments will be able to mitigate the \$4.1 billion impact of COVID-19 in 2020. Additionally, the Government of Ontario is providing an additional \$500 million to support municipal operating pressures and recovery in 2021.<sup>viii</sup>

<sup>2</sup> The Province is contributing \$2.2 billion; the federal government is contributing \$1.8 billion.

<sup>3</sup> An addition to the SRA was announced at the end of 2020, with the Government of Ontario pledging a further \$695 million to stabilize municipal budgets in 2021.



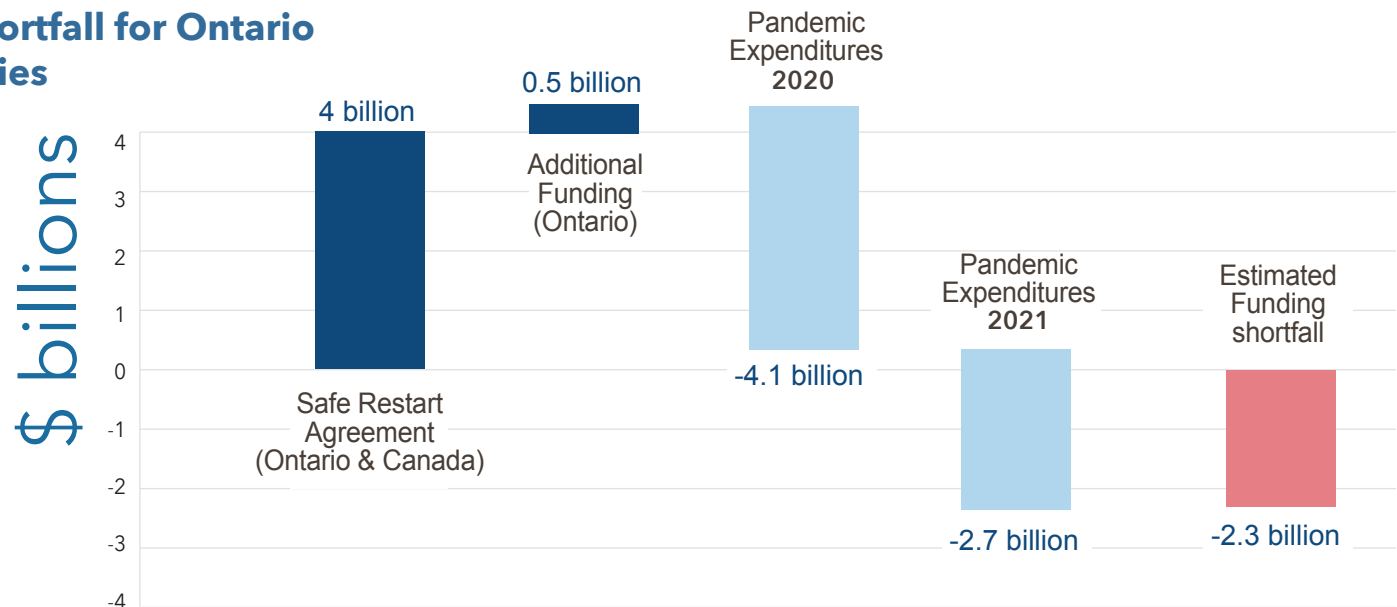
Municipalities in Ontario are facing a triple threat this year: an on-going pandemic that has hindered their local economies; reduced revenue from closed or limited services; and increased spending on public health and human services. The FAO estimates the pandemic will collectively cost municipalities \$2.7 billion in 2021, on top of the expected \$4.1 billion impact of 2020.<sup>ix</sup>

Given that local governments in Ontario cannot run budget deficits, their current options for fiscal sustainability are limited to tax increases, service cuts, and the use of reserves. While those tactics must certainly be kept on the table, arguably now is the time for both municipalities and the Province to explore alternative means of achieving fiscal sustainability.

This need for alternatives is well supported by data. Above and beyond the \$1.2 billion drop in transit revenues in 2020, the FAO projects that ridership will reach only 42 percent of normal levels in 2021, robbing many municipalities of \$0.9 billion in revenue.<sup>x</sup> Furthermore, user fees are expected to decline by \$0.3 billion in 2021 (on top of a \$0.5 billion drop in 2020), while lost revenue from permits and licenses is estimated at \$0.2 billion in 2021 after a \$0.3 billion decline last year. Other sources of municipal funds – including traffic and parking fines, gaming revenue, and investments – are also projected to shrink.<sup>xi</sup> All told, the estimated change in revenue for 2020 and 2021 is four percent, a substantial share for small governments with limited revenue-generating powers.

Altogether, the result is a funding shortfall of more than \$2 billion for Ontario’s municipalities.

### 2020-2021 Estimated Funding Shortfall for Ontario Municipalities



# Case study

## KPMG's City Competitiveness Index

The fiscal resilience of a municipality hinges largely on its ability to attract and retain businesses.

Now more than ever, those investors need reliable, comparable, and readily available data to inform their investment decisions. That is what led KPMG to develop the *City Competitiveness Index*.

Selecting the best business location requires careful consideration of a range of variables. When contemplating expansion, consolidation, or relocation, companies typically perform a comparative assessment of those factors — particularly location-sensitive cost factors including labour, taxes, facilities, transportation, housing affordability, and utilities.

Qualitative factors also influence a company's location decisions. Especially important are variables such as availability and quality of talent, innovation enablers (e.g., access to universities research programs), ease of doing business, and quality of life.

Despite the importance of this data, there is a significant gap in its availability. All too often, investors lack access to in-depth information about key competitiveness indicators for North American cities. KPMG knows Ontario is talented, innovative, and connected – but it wanted the data to do the talking.

Cities across Ontario are full of growth opportunities. They are competitive and resilient. They are increasingly focused on the green economy. Their residents enjoy a high quality of life and a stable socio-economic environment. But their strengths can go unnoticed. This is often the result of preconceived notions or a lack of easily accessible information.

The *City Competitiveness Index* addresses this gap. It provides meaningful analysis of cost and non-cost factors alike. It benchmarks 62 cities against 12 common cost structures and operational requirements — or “business personas”. To build this tool, KPMG analyzed and collected over 55 sources of data from globally recognized institutions and assessed over 300 metrics across 12 countries.

Most importantly, it helps ensure the benefits of cities across our province are presented with evidence and facts.

KPMG's innovative benchmarking approach is focused on rooting analysis in market realities — on providing insights that matter to investors. The result is an interactive digital tool, the complimentary *City Competitiveness Index* digital tool, where you can refine and tailor insights that matter to you.

Easily compare the competitiveness of featured cities at [City Competitiveness Index \(kpmg.com\)](https://www.kpmg.com/citycompetitivenessindex)



# Policy Recommendations

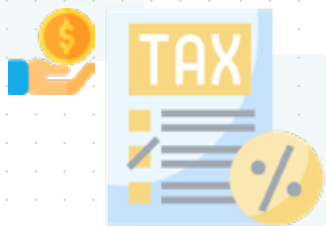
The remainder of this brief outlines policy recommendations focused on three aspects of municipal finance in Ontario:

- ◇ Taxes and fees
- ◇ Intergovernmental transfers
- ◇ Autonomy and governance

This is not intended to be a comprehensive review of all municipal financing options; additional tools that are beyond the scope of this brief include land transfer taxes, development charges, and municipal bonds. Rather, the suggestions below reflect a few important priorities identified by the business community and local communities.

## TAXES & FEES

One of government's most important mandates is to allocate resources in ways that elevate the public good. To do so, they must maximize value for taxpayers by collecting and spending revenue as cost-effectively as possible.



## Property taxes

In Canada, unlike most other countries, municipalities rely heavily on property-associated taxes instead of other taxation methods (such as those related to income or sales). In Ontario, property taxes constitute approximately 40 percent of municipal revenues.

Property taxes are both lauded and criticized for their perceived efficiency and suitability to municipal fiscal policy. Historically, property values were useful pieces of information for the level of services and investments a property received from the city, as larger households or businesses bought larger properties, which commanded more waste management, water, snow removal, and road infrastructure. However, as speculation and real estate development have decoupled the value of land from its potential economic value, the ability for property value to predicate usage of municipal resources is tenuous at best. In other words, a hot real estate market will lead to higher property taxes, whether or not municipal service costs go up.

Property tax in Ontario has a special character, in that both municipal and provincial orders of government charge it. Seventy-one percent of property taxes go to municipalities; the remainder are education taxes levied by the Province.<sup>xii</sup>

Until recently, these education taxes represented some of the most unequal variations in taxes between communities and between residential vs. non-residential taxpayers. In the 29 municipalities comprising the Golden



Horseshoe, commercial and industrial property tax levied to fund education was six times higher than that levied on residential properties.<sup>xiii</sup> In its 2020 Budget, the Ontario government announced a standardization and reduction of all Business Education Tax rates to 0.88 percent starting January 2021, which will result in lower costs for 94 percent of all business properties in Ontario.<sup>xiv</sup> This type of intervention from the government is critical to supporting the recovery of local businesses and communities after the pandemic.

More broadly, now is the time for the Government of Ontario to **undertake a comprehensive and forward-looking review of Ontario's property tax system**. In 2020, the Province postponed the anticipated property tax assessment and extended this postponement in 2021 to provide businesses and residents more stability while allowing municipalities to focus their attention on responding to the pandemic. The government should **extend the pause on the existing property tax assessment cycle** until a more equitable and efficient property tax regime can be established. Ideally, in the context of a review of the property tax system and a provincial-municipal service responsibility re-alignment, the Province should **eliminate the provincial share of non-residential property taxes**, providing relief to businesses and some long-term room to maneuver for municipal governments.

As noted above, property tax assessments are derived from the perceived value of properties. For non-residential assessments, real estate value is assessed for its highest and best use (HABU), meaning that the value of the structure on the land is actually of little consequence to the assessed value of land. Instead, value is assessed for what it *could* be if developed to its maximum potential. Therefore, a parking lot zoned for a commercial office tower might be charged a property tax similar to that of a nearby com-

mercial office tower simply because a commercial office tower would be the 'highest and best use' of the parking lot. This results in higher-than-appropriate property taxes for many businesses, particularly small ones. With unaffordable tax rates, small businesses are unable to flourish and grow within their communities, resulting in less economic activity and (paradoxically) lower long-term tax revenues for municipalities.

In the long-term, establishing a more dynamic property tax assessment system more capable of gauging both need and capacity to pay would offer greater tax efficiency for businesses which rely more on real estate, such as brick and mortar retail stores and restaurants. While HABU may result in higher tax revenues for the municipality, it is often an unfair financial burden, particularly on those businesses that have been hardest hit by the pandemic. As a means of providing relief to local industry, the Province and municipalities should **re-consider the use of HABU as part of their property tax assessment regimes**.

A further challenge with the current assessment model is a lack of predictability. Businesses are currently limited in their ability to forecast long-term expenses because they are unable to determine what their property tax expenses will be in the future, as property taxes can vary wildly between the four-year assessment increments. This uncertainty costs businesses money as they must contend with and plan around the long-term liability of having to pay far more in property tax. **Providing more frequent property assessments, expediting property assessment appeals processes, or partially indexing property tax rates to a benchmark** (such as inflation) may offer ways to mitigate this uncertainty. More certainty for the private sector leads to increased confidence and investment, which results in higher tax revenues for local and provincial governments.

## Targeted Tax Reform Supports Small Businesses During Economic Recovery

In its 2020 Budget, the Government of Ontario granted municipalities a new option to create a small business subclass to offer targeted tax relief for the hardest-hit part of the economy. While there are legitimate questions as to how this new power will function (including how to define such a subclass), it represents an opportunity for greater municipal tax reform. In Ontario, the Province sets limits on the ratio of municipal tax rates, constraining local flexibility and increasing the burden on some taxpayers when others are offered relief. Given the assistance being provided by the Province to ensure that this subclass has limited impact on other taxpayers, it could represent a learning experience that may dictate how the Province should proceed with allowing greater local flexibility in taxation.



### Fees and fines

Reflecting upon the changes COVID-19 brought to municipal services, local governments should **review their catalogue of user fees, permits, licenses, and fines to consider how these can be adjusted to reflect changes in demand.** For example, rentals of large event venues will likely be close-to-nonexistent well into 2021. How can a municipality extract greater value out of fees and fines, as an alternative to raising taxes?

Where appropriate, municipal governments should explore differentiated levels of pricing by time, size, location, and/or convenience. For example, governments could consider offering express tiers of service at a higher fee or increasing the number of transactions for which residents must pay a fee. However, in all cases, equity and accessibility must be prioritized to ensure individuals are able to pay for the public services they need. For instance, Finland's traffic violation system scales fines based on the income of the individual violating the law.<sup>xv</sup>

Reviewing user fees is not merely a response to pandemic pressures, but also an approach for making use of government services more efficient. When there is no charge assigned to a service, more of it will be consumed than its users would otherwise be willing to pay. Usually, if a service is assigned a charge, residents will only use that service in direct accordance with the value it offers them, aligning the price of the service with the cost borne by the government offering it.



## Municipal Accommodation Tax

In 2017, municipalities in Ontario were granted the authority to impose a Municipal Accommodation Tax (MAT) on facilities offering accommodation stays under 30 days. The MAT was created to enhance investments in tourism marketing and product development with the ultimate aim of growing Ontario's tourism industry.

The tax is uncapped and non-voluntary, meaning that municipalities are free to impose it unilaterally and set the rate at any level they choose. Fifty percent of MAT revenues must go towards a tourism entity to support tourism promotion and development, while the remaining 50 percent goes towards the municipality's budget.

Improving accountability around the MAT would go a long way in protecting tourism industry jobs and industry competitiveness, particularly in light of the pandemic's considerable impacts on this sector.

Specifically, the Government of Ontario should **implement an official rate change process** to prevent municipalities from increasing or decreasing the MAT at their own discretion. Ideally, any official change to the rate of the tax should be voluntary for the impacted businesses, and the application for a rate change should require direct consultation with the eligible tourism entity and accommodation sector to reach a mutual agreement.

Further, the Province should **establish clear, robust, and enforceable rules to clarify how municipalities may use MAT funds**. Their spending of the funds should have a clear and explicit link to benefitting tourism in the region. This could require municipalities to have a local tourism strategy in place prior to implementing the MAT.



## INTERGOVERNMENTAL TRANSFERS

When municipalities are unable to raise the revenue required to fund projects that would be of value to their community, they often turn to intergovernmental transfers as an alternative source of funds.

Transfers are useful in cases of an insufficient tax base, which is often the reality for small municipalities. Grants from higher orders of government are also useful for compensating local governments for funding services that create positive impacts on the surrounding region, such as regionally beneficial infrastructure.<sup>xvi</sup> Finally, given the monetary capacity of the Canadian government, grants may be an effective tool to assuage the effects of economic downturns on municipal government revenue generation, due to their limited ability to take on debt. This is especially pertinent now, given the devastation the COVID-19 pandemic has inflicted on local economies.



### Review of existing transfers

While local governments are mostly responsible for direct services such as roads and libraries, their portfolio of distributed services – such as public health and social services – has been growing as higher tier governments have increasingly downloaded responsibilities onto them. From a governance perspective, many of these distributed services are best managed by municipalities, as they have the best knowledge of local economic and social dynamics.

However, in meeting these responsibilities, municipalities have been challenged in their ability to accrue the required funds. Conventional means of revenue generation provided to municipalities, such as property tax, while suited to services like transportation given the dependence of property on transportation networks, are poorly suited to the provision of distributed services such as social assistance, which are disconnected from property.

Understandably, the dual pressures of revenue and expenses on municipalities, especially owing to the human impact of the pandemic, has meant that addressing this imbalance is more relevant than ever. As part of a recovery plan, the Ontario government should **take a leadership role in ensuring it is not adding fiscal pressure to municipalities when they are least able to afford it**. This could be achieved through:

- a. Commissioning an independent review of all municipal responsibilities to assess, in terms of absolute cost and service delivery, whether residents and taxpayers are better served by these responsibilities residing with the federal, provincial, or municipal governments.
- b. Accompanying all transfers of responsibilities with sustained funding adequate to service delivery needs. Currently, intertwined services are funded through cost-sharing agreements that rarely adhere to rational criteria, such as fiscal capacity or population.<sup>xvii</sup>
- c. Consulting with municipal governments and the business community before embarking on provincial services reviews or cuts that would impact municipal government services.



## New transfers

The proposed small business subclass announced in Ontario's 2020 Budget (giving municipalities flexibility to target tax relief to small businesses as they recover from the COVID-19 crisis) has potential to make a positive impact, in large part, because it is a form of local relief. Providing municipal governments with enough autonomy to decide the best and most appropriate emergency relief for their communities is a critical part of their recovery. It makes the best use of the on-the-ground knowledge of, and close relationships with, their business communities.

The Province could take this initiative further by implementing an immediate measure to **support communities with new provincial and federal transfers directed towards non-residential tax base relief funds**. These funds should be open to both non-residential property owners and tenants. Such a measure could be accomplished by using the existing SRA framework. Any monies provided should be available for grant programs, tax relief, or other supports municipalities deem appropriate to their local business communities. However, SRA guidelines for these new funds should dictate that they be targeted towards economic recovery. The goal of this new support should be to create temporary, directed, transparent, and immediate relief to local economies.



## Future transfers

One action the Province can take that would have a considerable impact on municipalities' long-term fiscal sustainability would be to avoid unfunded mandates. This should be achieved by **adhering to the 'pay-for-say principle'**, which dictates that if an order of government has input into the operation of a service, it has a corresponding responsibility to fund that service. If a service requires regulation and/or standardization at the provincial level, it should primarily be the responsibility of that order of government to pay for it. Similarly, the more local input is required, the greater the municipal funding responsibility should be.<sup>xviii</sup> This principle must be dynamic, however, as needs change over time. The Province should consider mimicking Denmark's Extended Total Balance Principle. If a decision at the provincial level results in increased costs for municipalities, then the Province is required to compensate them – and vice-versa, as municipal savings resulting from a provincial decision would be expected to be returned to the higher order of government.<sup>xix</sup>

A major factor impacting the ability of municipalities to meet their responsibilities with respect to cost-sharing arrangements is their size. Municipalities with populations under 10,000 have the largest budget variation among Ontario communities, ranging from a deficit of 31.6 percent of revenue to a surplus of 70.2 percent (in 2018). This is explained by their exposure to the volatility of intergovernmental transfers: for small governments, these transfers may represent up to 71 percent of total revenue.<sup>4</sup> The Province should do more to consider local revenue capacity and regional differences when assigning criteria for cost-sharing agreements and funding models. This includes appreciating how the volatility of intergovernmental transfers can endanger the ability of smaller municipalities to balance their budgets.



<sup>4</sup> It is also worth noting that there are 428 municipalities with fewer than 10,000 residents in Ontario, representing 96 percent of communities. Therefore, variation may be expected within such a large sample. FAO, 2020.



## AUTONOMY & GOVERNANCE

Strong governance and local autonomy are critical to public confidence and municipalities' ability to provide value to their communities. Transparency ensures taxpayers understand where their money goes and helps the public appreciate the tactics required to address local challenges. Businesses are particularly interested in budgets, as keeping an eye on government investments and tax policy is critical to their own decisions around growth, investment, and/or relocation.



## Accounting

The disconnect between end-of-year balance statements and budgets can make it difficult for individuals and businesses to understand how their municipality is spending tax dollars, limiting the transparency and accountability of the government. Connecting budgets and end-of-year balance statements would allow a more informed critique of a municipality's spending habits and provide taxpayers a better understanding of their government's fiscal outlook. Due to the high visibility of most municipal taxes, such as property taxes and user fees, local taxpayers are more inclined to understand (and care) how their tax dollars are being used. It is therefore in municipal governments' interest to provide an accessible and transparent look into their sources of revenue and their uses. Local government needs to improve availability of public information to allow for a more informed electorate able to more effectively advance public discourse and direct elected officials.

For example, to avoid possible misinterpretation of an 'accounting surplus' as an actual surplus, some local governments present an additional 'modified accrual' budget.<sup>5</sup> The modified accrual budget offered by York Region, for example, looks to reconcile possible surpluses that could arise between operating and subsequent financial statements and allows for greater ease in translating the spending goals set out at the beginning of the year to what was actually realized in the financial statements at the end of the year.

Therefore, to improve transparency and constituent engagement, **municipal governments should issue modified accrual budgets at year-end.** Such documents could attempt to describe basic accounting concepts and why and how budgets might differ from end of year financial statements.<sup>xx</sup> Local governments should view financial reporting as an opportunity to inform the public of both the constraints and opportunities they are facing, to improve residents' understanding of the challenges they can expect to face, and how municipalities fit within the larger governance structures of the provincial and federal governments.



<sup>5</sup> Modified accrual accounting combines cash-basis accounting and accrual-basis accounting. Revenues are recognized when they become available and measurable, while expenditures are recognized when liabilities are incurred. For example, a municipality can decide to purchase an asset today and only record the expense (and a reduction in net income) when the money is actually spent. The advantage of the modified accrual accounting method is that it aligns with local governments' focus on current-year obligations, allowing them to demonstrate clearly whether current-year revenues are sufficient to finance current-year expenditures, and whether resources are being used according to legally adopted budgets. In practice, it avoids the appearance of a surplus when excess funds are earmarked for a future purpose.

## Interest arbitration

Outside of the COVID-19 pandemic, one of the longest-standing pressures on municipal budgets outside of major metro areas has been the interest arbitration system – the only legal mechanism available to Ontario municipalities for settling disputes from contract negotiations with services such as police and fire. While protection services are essential to community safety, the costs of these services have increased at over three times the rate of inflation annually between 2002 and 2016.<sup>xxi</sup> Our principal concern is that the current system does not adequately consider the capacity of municipalities to pay; therefore, reform of the interest arbitration system is essential to supporting local government through the recovery period and beyond.

In certain regions of the province, particularly rural or remote areas, the awards granted by arbitrators are disproportionate to existing revenue sources available to local governments. For example, Owen Sound spent 29 percent of its expenses on police and fire services in 2019, while the Town of Innisfil spent 26 percent.<sup>xxii</sup> For comparison, 17 percent of Owen Sound's expenses went towards transportation that year.<sup>xxiii</sup> As a result, these municipalities have fewer resources available to direct towards other core services and investments that *also* impact the health and safety of their communities – such as maintaining water infrastructure.<sup>xxiv</sup>

Given the increased need for spending on public health and social services thanks to the pandemic, it is critical that municipalities be given more fiscal room within their budgets. It would be inappropriate to suggest that this issue should be resolved by municipalities through a tax increase given the current economic climate.

In 2018, the Government of Ontario modernized the interest arbitration system for the firefighting sector by *amending the Fire Protection and Prevention Act, 1997*. These amendments will: update the system to reflect the current capacity of municipalities to pay for increased service costs; improve efficiency by requiring that arbitration decisions be delivered within four months; and improve accountability and transparency for taxpayers by requiring arbitrators to provide written reasons for their decisions if requested by either party.

**The Province should make similar reforms to the interest arbitration system for police services** through updates to the *Police Services Act, 1990*. The arbitration system for all protection services should include an analysis of the existing municipal tax structure and available revenue streams. Similarly, arbitrators should be required to publicly release a written explanation of their decision which prioritizes how the fiscal health of a community was considered. Lastly, the Province could improve efficiency by requiring that arbitration decisions be delivered in less than 12 months. In cases where a decision is not delivered within 12 months, the issue should be directed to the Ontario Labour Relations Board for final award.



## Local governance

Ontario currently supports municipalities to find efficiencies within their budgets through the Municipal Modernization Program and the Audit and Accountability Fund, as well as a provision within the *Municipal Act* which allows them to appoint an Auditor General.<sup>6</sup> Given the scope of need created by the pandemic, it would be wise to **centralize and formalize these supports as permanent programs for the long term.**

In 2012, British Columbia created the office of the Auditor General for Local Governance (AGLG), which audits municipalities, provides advice on budget improvement, collects and disseminates best practices, and runs comparison studies on locally delivered services.<sup>xxv</sup> The Government of Ontario should **establish a similar Auditor General for Local Governance** to assist municipalities in delivering the best value-for-money for their residents.



## Regional collaboration

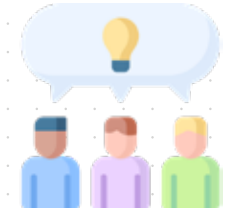
Collaboration and cost-sharing between municipalities could have tremendous benefits in Ontario, particularly in growing regions where residents live, work, and play across municipal borders. There is a formal approach that the Province could enable, known as voluntary co-operation, wherein two communities enter into a contractual agreement to share resources. In such a model, individual municipalities maintain their autonomy and can govern as their constituency demands. Communities can renegotiate, assemble, and disband as their needs and demographics evolve over time. Particularly given the fiscal constraints created by the pandemic, the need to leverage existing infrastructure will be of increasing importance. Municipalities in proximity of one another would therefore be wise to explore how to exploit economies of scale.

Voluntary co-operation also offers a structure by which externalities imposed by one municipal region onto another can be mitigated via agreement to share costs in exchange for continued investment and/or influence over decision-making. For example, if residents of one municipality are using a bridge built by another municipality to the point where the bridge is now crowded (imposing an economic externality on the community), an agreement can be drawn up whereby both municipalities pay to have the bridge expanded.

Currently, most inter-municipal coordination is inefficient, competitive, and reliant on provincial approval and oversight. While frameworks exist for establishing memorandums of understanding, many municipalities are hesitant to use them. If emboldened and supported to independently form agreements with neighboring municipal and regional governments, communities could ensure services, investment, and infrastructure are complementary, non-competitive, and effectively utilize limited resources. The Ontario government can help **identify potential areas of alignment between municipalities** with shared needs or priorities. It can also **champion partnerships that have worked well** as models that can be replicated elsewhere.

<sup>6</sup> In 2021, the Ontario government provided almost \$10 million to large municipalities through the Audit and Accountability Fund – which supports initiatives that focus on increasing digital services, modernization, streamlining, and service integration – and over \$40 million through the Municipal Modernization Program to help small and rural municipalities improve the delivery of their critical local programs and services during COVID-19.

The Government of Ontario should therefore continue to explore how inter-municipal agreements might be optimally structured in an Ontario context and work to **inform municipal governments of how they might better engage in voluntary co-operation** to both increase value for tax dollars and better coordinate services for their residents. To incentivize such collaboration, the Province can develop a mechanism that allows multiple municipalities who have invested in a regionally significant project to account for jobs created proportional to financial contribution when reporting to government. However, the Province's involvement should be limited to promoting and supporting collaboration, without mandating it or requiring it as a precondition to access funding, as collaboration tends to fail if it does not develop organically based on shared interests.<sup>xxvi</sup>





## Conclusion

While the COVID-19 pandemic has challenged municipalities and businesses across Ontario, it has also exposed and exacerbated existing weaknesses within municipal fiscal governance. The business community feels there is a window of opportunity to re-align the funding relationship between orders of government and encourage pro-growth decision-making among municipal governments. This would both aid with post-pandemic recovery and ensure that communities across Ontario can prosper over the long-term.

This brief offers 14 recommendations for Ontario’s provincial and municipal governments, developed with input from businesses and their local chambers of commerce and boards of trade. Our work should be considered in conjunction with prior research on the topic of municipal financing.<sup>7</sup>

Taken together, these policies will support fiscal sustainability, economic development, and growth in communities across the province for years to come.

<sup>7</sup> For example, the Mowat Centre has recommended “expenditure side approaches to improve service efficiencies, such as service integration across siloed departments (modelled on successful human services integration that Peel undertook), outcomes-based funding models, and exploration of innovative financing models such as social impact bonds.”

# Appendix



## Major services partially or fully funded by municipalities<sup>xxvii</sup>

### GOVERNMENT ADMINISTRATION

Planning and Development  
Planning, zoning, severances, approvals  
Local economic development

### ROADS

Local roads  
Sidewalks  
Streetlights  
Parking  
Throughways

### PUBLIC TRANSIT / PUBLIC HEALTH / SOCIAL SERVICES

Welfare assistance  
Day care services  
Children's assistance  
Homes for the elderly  
Social housing

### PROTECTION

Police  
Fire  
Emergency planning

### RECREATION AND CULTURE

Community parks  
Recreation programs and facilities  
Local libraries  
Community centres, theatres  
Convention facilities

### ENVIRONMENT

Water supply and distribution  
Sewage collection/treatment  
Solid waste management

# Endnotes

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