Item 10.1.

Section III – Items for the Information of the Board

TO: Chair and Members of the Executive Committee
Meeting #4/19, Friday, May 03, 2019

FROM: Michael Tolensky, Chief Financial and Operating Officer

RE: **BUDGET COMPOSITION**
Improving Accountability and Transparency of TRCA's Budget Process

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KEY ISSUE
Educational report regarding Toronto and Region Conservation Authority's (TRCA) budget composition due to potential changes in the Conservation Authorities Act (the Act).

RECOMMENDATION

IT IS RECOMMENDED THAT the Budget Composition report be received.

BACKGROUND

BUDGET COMPOSITION
The financial composition of TRCA has changed substantially since the organization's establishment in 1956. For example, for the year ended December 31, 1968, $928 (all dollar values in this report are in thousands of dollars) of revenues generated by TRCA came directly from the Province ($475 or 51.2%) and partner municipalities ($453 or 48.8%). Over the next 50 years, TRCA leveraged its considerable competitive advantages to increase its annual revenues to $118,643 for the year ended December 31, 2017, primarily with support from its partner municipalities ($72,662 or 61.2%) and generated fees ($38,410 or 32.4%). TRCA's fiscal 2017 financial statements are provided as *Attachment 1*, for reference purposes. Provincial financial support, including grants, in 2017 was $6,944 or 5.9% of the organization's revenues, which is indicative of the funding approach that the Province has taken towards conservation authorities since the mid-1990's, offloading increased financial obligations to partner municipalities.

For the year ended December 31, 2017, TRCA's capital budget totaled $72,187 (62.1%), while the remaining allotment of $43,982 (37.9%) was attributed to the organization's operating budget. In the current Act, neither operating nor capital expenses are defined. As a result, TRCA adopted a method in which the determination of whether a project or program should be included in the operating or capital budget was based on funding source. As a result of the Province's change in funding methodology for conservation authorities in the 1990's, many of TRCA's programs and related costs are funded by partner municipalities' capital/special benefitting levies, which form a substantial portion of the organization's capital budget. Through TRCA's involvement in the review of the Act in 2017, the following definition has been added, pending Royal Ascent, as follows:

"operating expenses" include,
- *(a) salaries, per diems and travel expenses of employees and members of an authority,*
- *(b) rent and other office costs,*
- *(c) program expenses,*
- *(d) costs that are related to the operation or maintenance of a project, but not including the project's capital costs, and*
- *(e) such other costs as may be prescribed by regulation;*

While such a change will not impact how TRCA is funded, it will provide greater transparency to our Board, partner municipalities and stakeholders, regarding the organization's operating budget which is currently understated. Given that the Act is pending Royal Assent, TRCA is yet to change its approach to budgeting for 2019. However, the organization expects approval on the 2019 TRCA budget to be received while the Act review is ongoing. Staff have already commenced the process of amending the budget for 2020 and discussed this matter with staff in its partner municipalities during budget discussions for the previous two fiscal years.

OPERATING LEVY
(2017 Revenue: $13,928)
The purpose of the levy, according to the Act, is to make a conservation authority whole for administrative costs incurred, by allowing each conservation authority to apportion costs to its participating municipalities according to the benefit derived. To determine the benefit derived, TRCA utilizes Current Value Assessment (CVA) data, which is provided to each conservation authority by the Ministry of Natural Resources and Forestry (MNRF), based on the best available property assessment levels for each partner municipality. Due to varying assessment growth rates throughout the jurisdiction, there are normally marginal changes in the annual allocations when the data is provided, which is normally in the fall for the subsequent fiscal year.

TRCA's operating levy is normally broken down into four components: (1) Matching; (2) Non-Matching; (3) Municipal Property Tax Adjustment and (4) Non-CVA Levy. The first, Matching, is a recognition that the first portion of funds received from the CVA calculated operating levy matches funding received from MNRF ($744 in 2018). The second, Non-Matching represents the amount in excess of the matching funding that also adheres to the CVA formula. The third, Municipality Property Tax Adjustment, is a recognition that certain partner municipalities charge TRCA property taxes and rather than use other partner municipalities to pay these fees, the property taxes are charged back to the billing partner municipality. The final component, Non-CVA Levy, is a point of contention which leads into two challenges.

The first challenge is that each partner municipality has their own unique budget requirements and pressures and TRCA works with staff/councils to maximize funding opportunities and identify synergies across the jurisdiction, rather than strictly adhering to the CVA formula. Partner municipalities dictate their financial capacity regarding operating levy contributions and TRCA agrees to work within the provided funding envelopes. Given that partner municipalities have always supported a multitude of projects and programs within their jurisdiction, the practice of formally levying an amount in excess of this envelope to cover operating expenses has been frowned on. Since 2011, the Non-CVA Levy has grown from $22 to $647 in 2019 (representing 4.4% of the operating levy).

Through conversations with municipal staff throughout the 2019 budget process, it became clear that staff were not aware of the pervasive nature of this issue. A comprehensive budget note (*Attachment 2*) was provided to the City of Toronto, outlining the matter and proposing a possible resolution. To date there has not been endorsement from staff or council on the matter.

The second challenge is that operating funds have been used to subsidize TRCA programming. In 2017, for example, only $7,719 (or 55.4%) of the $13,928 budgeted operating levy was allocated to Corporate Services, with the remainder shared throughout the organization's service areas including Tourism and Recreation ($2,111 or 15.2%), Education and Outreach ($1,741 or 12.5%) and Watershed Studies and Strategies ($1,374 or 9.9%).

While the allocation is permissible in accordance with the Act, the usage of levy to subsidize programming has negatively impacted TRCA's ability to fund core services in a financially sustainable manner. TRCA staff propose that operating levy should solely be used to cover core programs and services that are required by regulation, including continuing to support Corporate Services.

The creation of the Corporate Services division in March 2018 highlighted that TRCA's internal services have not developed sufficiently to support the wealth of projects and programs provided by the organization, emphasizing the need for additional funding.

RELATED CHANGES TO THE ACT

This staff assessment is consistent with the recent creation of Section 21.1 (1) of the Act, which notes that there are three categories of programs and services that a conservation authority is required or permitted to provide within its area of jurisdiction, including:

1. *Mandatory programs and services that are required by regulation.*
2. *Municipal programs and services that the authority agrees to provide on behalf of municipalities situated in whole or in part within its area of jurisdiction under a memorandum of understanding*
3. *Such other programs and services as the authority may determine are advisable to further its objects*

Further changes to the Act, pending Royal Ascent, provide guidance to conservation authorities on how to establish formal relationships for the second category of programs and services, as publicly available memorandums of understanding are required, to increase transparency of the roles of conservation authorities in their jurisdictions. TRCA supports this amendment, as similar types of agreements are already used with a variety of funding partners, including municipalities. TRCA anticipates using a full cost recovery model for these agreements, in order to recover all direct and indirect costs incurred in providing the specific projects and programs. Regarding the third category, TRCA staff believe that if they are to be offered, they must be self-sustaining on fees from specific funders for the programs and services, rather than utilize levy funds, which appears to be in line with stakeholder's expectations.

CAPITAL LEVY
(2017 Revenue: $38,292 - Deferred Revenue: $13,317)

The purpose of capital levy, according to the Act, is to allow a conservation authority to recover funds required for capital expenditures in connection with any project. In practice, TRCA's capital levy has evolved over the years, based on partner municipality consent to include projects and programs requested by the municipality and those determined by TRCA to further its objects. In order to allocate benefit between the partner municipalities, TRCA utilizes one of three methods: (1) CVA formula, (2) watershed formula (described below), or (3) apportionment of costs to a singular partner municipality, where an entire project or program is to be undertaken within one municipality's jurisdiction. The Watershed formula, introduced in 2017, is based on the number of hectares within each participating municipality. TRCA projects and programs deemed jurisdictionally benefitting to the partner municipalities are funded by this formula. The four major partner municipalities (Durham, Peel, Toronto, and York) participate in this apportionment formula.

Partner Municipalities	Current Value Assessment (CVA) From Province	Watershed Formula
Adjala-Tosorontio	0.00%	0.00%
City of Toronto	64.30%	25.90%
Durham Region	2.81%	14.50%
Mono	0.00%	0.00%
Peel Region	11.13%	25.80%
York Region	21.75%	33.80%
TOTAL	100.00%	100.00%

CVA Project and Programs

- Community Transformation
- Greenspace Acquisition
- Head Office Project
- Information Technology
- Major Facilities
- Planning and Regulation Policy
- Policy Development Review

Watershed Projects and Programs

- Aquatic Ecosystem Science
- Bioregional Seed Crop
- Climate - Research and Adaptation
- Flood Gauging
- Floodline Mapping
- Regional Monitoring
- Terrestrial Natural Heritage Inventory
- Terrestrial Ecosystem Science
- Watershed Plan Development and Reporting

Under the potential changes to the Act, many of the projects and programs using capital levy funds are defined as category two or three in Section 21.1 (1) of the Act, meaning that TRCA anticipates working with partner municipalities to create Memorandums of Understanding to govern these initiatives. Additionally, TRCA is currently developing an enterprise wide asset management program to inform a consistent approach to planning and decision making for management of the organization's tangible capital assets. This approach to asset management, which is consistent with the approach of partner municipalities, will help determine the prioritization of competing pressures which will guide discussions with stakeholders given limited financial capacity. As of December 31, 2017, TRCA's capital reserves were $1,758 compared to tangible capital assets of $461,869 which provides limited capacity to deal with infrastructure issues as they arise.

In potential scenarios in which a partner municipality no longer agrees to fund an existing category two TRCA project or program, TRCA has three options: (1) initiate a Memorandum of Understanding with a different municipality to fill the funding shortfall, (2) find funding opportunities to convert the project or program into a category three offering, or (3) work with the partner municipality on an exit strategy.

Additionally, TRCA receives significant funding for contract and other services from partner municipalities that already fit into category two initiatives, which amounted to revenue of $20,442 in 2017, plus an additional $3,259 of deferred revenue for future initiatives. TRCA anticipates category two initiatives will grow substantially once changes to the Act are ratified.

AUTHORITY GENERATED REVENUE
(2017 Revenue: $38,410 - Deferred Revenue: $14,791)
The final area of funding which could be impacted by changes to the Act pertains to authority generated revenue, which has grown to over 30% of TRCA's total income. In *Note 8* of the 2017 Financial Statements (*Attachment 1*) is an overview of how these funds are generated, however there is a sizeable range in activities for which TRCA charges fees to end users, including, but not limited to, permits, admissions and programming.

In concurrence with the anticipated change to Section 21.1 noted above, the Province added Section 21.2 on fees for programs and services, pending Royal Ascent, which contains the following pertinent wording:

1. *The Minister may determine classes of programs and services in respect of which an authority may charge a fee.*
2. *The Minister shall publish the list of classes of programs and services in respect of which an authority may charge a fee in a policy document and distribute the document to each authority.*
3. *If the Minister makes changes to the list of classes of programs and services in respect of which an authority may charge a fee, the Minister shall promptly update the policy document referred to in subsection (2) and distribute the new document to each authority.*
4. *An authority may charge a fee for a program or service that it provides only if it is set out on the list of classes of programs and services referred to in subsection (2).*
5. *The amount of a fee charged by an authority for a program or service it provides shall be, (a) the amount prescribed by the regulations; or (b) if no amount is prescribed, the amount determined by the authority*

At this point in time, it is unclear if any of TRCA's projects or programs would be impacted by this amendment to the Act. TRCA has raised this uncertainty as a potential issue. If TRCA were no longer permitted to charge fees for certain programs or services and a partner municipality still requested TRCA to complete the service within its jurisdiction, a Memorandum of Understanding would be required, along with corresponding funding.

Relationship to Building the Living City, the TRCA 2013-2022 Strategic Plan
This report supports the following strategy set forth in the TRCA 2013-2022 Strategic Plan:
Strategy 9 – Measure performance

DETAILS OF WORK TO BE DONE
TRCA will work with partner municipalities to develop required agreements and to re-allocate funding appropriately, allowing staff to incorporate all changes within the Act, into reporting as part of the 2020 budget cycle. In preparation for the 2020 budget cycle, TRCA staff have been assessing the projects and programs within TRCA's Service Areas and have provided a detailed report and prestation entitled Budget Composition – Background for your reference (*Attachment 3*).

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