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City of Toronto's debt and credit rating implications

A municipality's credit rating and ability to borrow are closely linked. Credit rating agencies assess the City's debt position by comparing it with other cities and regions. If current debt levels and future trends appear to be high by comparison, it will have a negative impact on the City's credit rating. If debt levels are considered low, it will have a positive impact. The amount of debt and the City's ability to make payments on the debt now and in the future will affect the rating.

While the City's debt affects its rating, the rating affects the City's ability to borrow, as well as the cost of borrowing. A higher rating translates into a lower cost of borrowing, as well as a wider market for investors to invest in City debt. Below a certain rating, investors may have policies that don't allow them to purchase the City's debt. The City would then have to offer a higher interest rate to attract investors.

Ontario municipalities can borrow money for capital (e.g. roads, bridges, equipment, facilities) purposes. Cities cannot borrow for operations like senior governments. Debt can only be used to pay for capital projects that are approved by City Council. The total debt must be within limits established by the Province. Debt charges, consisting of principal and interest, are funded from the operating budget. They cannot exceed 25 per cent of the City's revenues, generally defined as property taxes and user fees.

The City of Toronto uses debt along with other methods of capital financing, such as contributions from current operations and reserves and reserve funds, to pay for the City's infrastructure requirements.

Debt matches the repayment term to the economic useful life of a project. Otherwise, today's taxpayers would be paying for the entire cost of a project that provides a benefit to future residents and businesses.

Historical and Forecasted Annual Debt Issuance Requirements (millions)

1992	1993	1994	1995	1996	1997	1998
\$125	\$225	\$99	\$49	\$222	\$129	\$250
1999	2000	2001	2002	2003	2004	2005
\$0	\$200	\$468	\$363	\$305	\$227	\$252

As of December 31, 2000 the City's total debt amount was forecasted to be \$1.8 billion (gross). While this amount is considered to be manageable today by comparison with other municipalities, it will double in five years unless capital expenditures are reduced or alternative and sustainable forms of financing are identified.

Over the past two years, the City has been successful in managing the elimination of provincial grants for transit and housing infrastructure without significantly adding to its debt. This has been achieved by employing a number of one-time funding sources such as the OMERS pension contribution holiday, a provincial grant of \$50 million and loans of \$200 million, asset sales of \$50 million, use of dedicated reserve funds (TTC

capital) and revenue from Toronto Hydro.

However, long-term solutions are required for the City to maintain reasonable debt levels based upon affordability and to protect and enhance its credit rating. The main source of increased debt is transit financing. This will increase the City's gross debt by an estimated \$810 million over the next five years.

The preliminary 2001 to 2005 capital program suggests that the City will experience a capital funding shortfall of \$213 million annually over the next five years, even after ambitious expenditure constraints by all programs have been factored in. The shortfall will have to be made up by either funding from senior governments or from higher property taxes to fund additional debt service costs.

The City will avail itself of all funding programs such as the provincial SuperBuild Fund and federal infrastructure initiatives in order to reduce this shortfall over the next few years. However, a permanent increase to available funding is the only way to avoid serious debt consequences for the City.

Currently, the City of Toronto's credit ratings are:

- AA (high) with a stable outlook from the Dominion Bond Service
- AA with a stable outlook from Standard and Poors Canada (merged with the Canadian Bond Rating Service) (Downgraded in January 2001)
- AA2 with a stable outlook from Moody's Investor Service

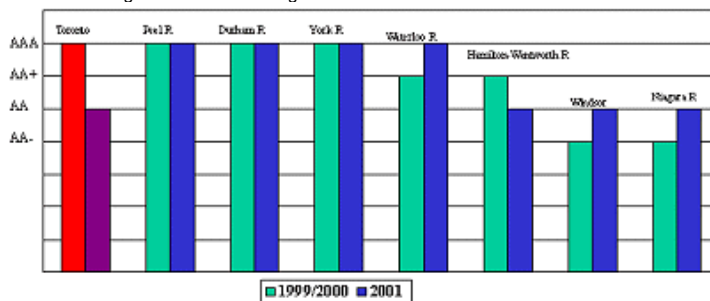
Credit Rating Scales - City of Toronto's rating in bold

DBRS	AAA	AA(high)	AA(med)	AA(low)	A(high)	A(med)	A(low)	BBB
S&P	AAA	AA+	AA	AA-	A+	A	A-	BBB
Moody's	Aaa	Aa	Aa2	Aa3	A	A2	A3	BBB

The City of Toronto is recognized as an important participant in global financial markets. The maintenance of a high quality credit rating is essential to insure that the City's ability to access the most cost-effective world capital markets will continue.

Comparison of Credit Ratings in Ontario

Click on the image below to view a larger version



Managing Toronto's Financial Condition

The City's tax-supported five-year capital program (2001-2005) contains projects totaling \$4.3 billion in gross expenditures with a year 2001 cash flow of \$1.2 billion. These forecasted capital requirements have the potential of doubling the City's gross outstanding debt in five years, if there are no reductions to the capital program and if additional revenue sources are not identified.

To date, the City has taken several measures to manage its debt levels. It

has:

- adopted the guideline of maintaining debt charges at no greater than 10 per cent of property taxes
- allocated increasing amounts of operating revenues to contribute to capital costs (\$146 million currently)
- directed returns from Toronto Hydro to finance capital expenditures

Additional action is required. Financing the five-year capital program will require the further development of prudent and reasonable debt management and financing policies, including capital targets that are realistic while addressing the priorities of the City's operating departments and agencies. The identification of alternative and sustainable sources of capital financing should also be pursued to allow the City to continue to maintain its existing infrastructure.

Independent verification of the City's financial condition is reflected in statements from the rating agencies:

- "Future capital expenditures for infrastructure, including public transit which faces increased needs, will be difficult to manage within Toronto's property tax regime, unless the province and/or federal government provides the City with new sources of revenues." The Dominion Bond Rating Service
- "Capital budget demands, mainly stemming from growth and from neglected maintenance and necessary improvements in transportation infrastructure, are making increasing demands on the City's budget." Standard and Poors
- "More long-term solutions are needed if the City is to maintain its low debt levels, while investing sufficiently in its physical plant." Moody's Investors Services