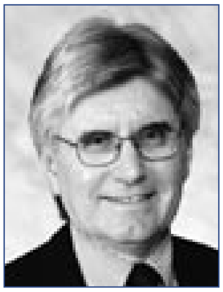
A MESSAGE FROM THE CHIEF FINANCIAL OFFICER AND TREASURER



The year 2004 marked the completion of the seventh year of the new City after the 1998 amalgamation. Despite numerous challenges, the City continues to post positive financial results.

2004 year-end financial highlights when compared to 2003 include:

- Cash and investments increased by $216 million to $2.438 billion.
- The City's investment in its government business enterprises (Toronto Hydro Corporation, Enwave District Energy Limited, Toronto Parking Authority and Toronto Economic Development Corporation) increased by $76 million to $1.035 billion.
- Toronto Community Housing Corporation's mortgage debt declined by $24.5 million to $992.6 million.

Other highlights:

The City's net financial liabilities increased from $1.60 billion to $1.97 billion, which is largely attributable to increases in net long-term debt to third parties (increased by $204 million to $1.681 billion) and employee benefit liabilities (increased by $186 million to $1.978 billion).

In 2004 the City completed the development of a Long-term Fiscal Plan that began in 2003. This is the first comprehensive financial plan put together by the new City to be used as a blueprint for future financial planning and discussions with funding partners.

In 2004, a Procurement Process Review was completed in response to a 2003 Auditor General's Report, and changes have been implemented in procurement spearheaded by the Purchasing and Material Management Division (PMMD). The goal of the review was to establish a procurement process that meets departmental operational needs in a cost-effective and expeditious manner while ensuring effective controls, accountability and reporting mechanisms to Council. Implementation started in 2004 and will continue to be rolled out in 2005. The new initiatives include changes to the overall procurement framework; implementing Service Level Agreements between PMMD and service departments; making compliance with purchasing and procedures a part of employee performance evaluation for those involved in the procurement process; organizational restructuring of PMMD; and developing and implementing new contract management processes.

Enhancements were made in the accounting systems as well. Three-way electronic vendor invoice matching was introduced in several divisions to improve the payment process. Internet payment options for residents were set up for Permit Parking, and Parking Tags, and preliminary pilots for the Purchasing Card program for City employees were established with Water and Wastewater and Corporate Services.

Budget process improvements were approved by Council in 2004 to refocus the budget process to improve accountability, increase stakeholder participation, and encourage openness, priority setting and direction. The New Budget Process includes measures that incorporate well articulated goals, key service measures and workforce information; ensure Council priorities influence the resource allocation process and decisions on service protection/enhancement; and accommodate multi-year budgeting.

Fiscal Sustainability

The City of Toronto presently maintains relatively low debt levels and high credit ratings through prudent spending decisions and sound financial management. Since 1998, the City has been able to hold the line on property taxes. Cumulative property tax increases since amalgamation (16.2% for homeowners and 1.5% for commercial, industrial and multi-residential property owners) are below the rate of inflation (17.1%).

The City has embarked on performance measurement and benchmarking, multi-year business plans, program reviews and prioritization, the goals of which are to ensure that key services are delivered in the most efficient and effective manner. As well, the City has introduced rigorous contract management, purchasing and financial controls to ensure that proper financial checks and balances are in place.

The annual budgeting process strives to maintain or enhance priority services delivered by City programs and services. This has been achieved through vigorous budget reviews, continuous improvements and efficiencies, and reductions with minor service impacts. Since Council directly controls only 25% of the gross operating budget, opportunities for savings and flexibilities are limited. The City has become more reliant on one-time measures every year to balance its budget. In 2004, these include one-time Provincial operating subsidy for the TTC, deferral of a $20 million Provincial loan repayment, $20 million in Provincial gas tax commitment, and applying Toronto Hydro revenues normally directed to capital programs to the operating budget. As well, the Province recognized the need for all taxpayers to share in tax increases required to sustain City services and in 2004 partially lifted the tax restrictions imposed by the Continued Protection for Property Taxpayers Act, 2000. Accordingly, the City levied a 1.5% increase on non-residential properties, which is half of the 3% increase on residential properties allowed.

The City has been managing its finances from year to year, yet it has a structural financial problem which can be categorized into the following eight issues:

1. The City has a higher cost structure than other municipal governments in the rest of the Greater Toronto Area, with higher costs in Police, Transit, Social Assistance, Social Housing and debt charges
2. Improper funding of Provincial cost-shared programs has resulted in significant financial pressures for the City.
3. The City lacks adequate revenue sources to fund its municipal responsibilities.
4. Demands for growth as laid out in the Official Plan or other sectoral and program plans are not adequately funded.
5. Business taxes are not competitive.
6. The City's investment in its ageing infrastructure has been lagging.
7. Employee benefits and other liabilities are not adequately funded.

Long Term Fiscal Plan

In order to address these financial issues, the City completed the development of a Long-Term Fiscal Plan in 2004 which was adopted by Council unanimously in early 2005. The Plan serves as a blueprint or framework for future financial planning and discussions with funding partners. The three categories are:

A. Expenditure Strategies

1. Longer term expenditure framework;
2. Review of the potential for revising the City's service responsibilities with other orders of government;

B. Revenue Strategies

1. Property tax competitiveness and related property tax strategies to maximize the property tax base;
2. Sustainable and targeted funding sources from other orders of government;
3. Other user fee revenue strategies and policies;

C. Asset and Liability Funding Strategies

1. Long-term capital financing;
2. Asset and liability funding.

Under the three main categories, the Long-Term Fiscal Plan recommends 24 financial strategies, 17 fiscal principles and five financial policies. These will assist programs and services in their planning and decision-making process to ensure the City is sustainable, maximizes its financial flexibility, minimizes its financial vulnerability, and remains competitive in the global economy.

Toronto will continue to benefit from the improved planning processes and internal administrative and financial controls; however, the current dependence on one-time measures to balance the budget is not sustainable. The City needs to address its structural financial imbalance which would otherwise lead to decreased competitiveness and a decline in its credit rating. Over the last few years there has been an increasing recognition by business organizations and the other orders of governments that Toronto requires new revenue sources and a legislative framework that align expenditure responsibilities with the appropriate sources of funding.

New Deal

Municipalities are not recognized as a government by the Constitution, but being Canada's largest city and Ontario's capital, Toronto residents pay $11 billion more to the Provincial and the Federal Governments annually in taxes and contributions than they get back in government spending. Since 2002, there has been an increasing support from independent organizations for the City to urge the other orders of government to increase their financial assistance to the City, including giving the City new revenue raising powers.

In 2004 the City began to see some positive developments from the two other orders of government:

- The Federal Government implemented effective February 1, 2004, a permanent rebate for Goods and Services Tax (GST) for municipalities, increasing the rebate from 57.1% to 100%. The benefit to the City has been estimated to be approximately $50 million annually.
- The announcement of a $1.05 billion, five-year tripartite agreement between the Federal Government, Provincial Government and the City of Toronto to cost share specified transit capital expenditures. The Government of Canada's contribution comes from the Canada Strategic Infrastructure Fund. This agreement provides an average $70 million per year from each government over five years to improve, modernize and expand the TTC and help provide better transit service to the TTC's 1.3 million daily riders.
- The Province has begun flowing a share (2 cents/litre) of the Provincial gas tax to municipalities to support local transit. This is being phased in over three years beginning with 1 cent/litre in October 2004, an additional ½ cent/litre in October 2005 and a final ½ cent/litre in October 2006.
- The Federal Government announced in its October 2004 Throne Speech and the 2005 Federal Budget its commitment to share gasoline tax revenues with Canadian municipalities. The agreement for the transfer of Federal gas tax revenues was subsequently signed on June 17, 2005.
- The Province announced increased support for local Public Health, increasing the cost sharing for certain programs from 50% to 75% by 2007.
- The announcement of a tripartite agreement between the Federal Government, Provincial Government and GO Transit with a total investment of $1.05 billion for 12 projects scheduled to be implemented over seven years 2004-2010. Each of the two other orders of government is responsible for $385 million in funding (with the Federal contribution coming from the Canada Strategic Infrastructure Fund). The municipalities in the GTA and Golden Horseshoe, including Toronto, are expected to contribute a total of $235 million of the $1.05 billion. This initiative is intended to improve the access, efficiency and capacity of GO Transit.
- The Federal and Provincial Governments have started working together on funding for Child Care and Affordable Housing which will ultimately benefit the City.

The above announcements primarily focused on capital funding are important first steps, but the City still faces a significant annual funding gap estimated at more than one billion dollars recently confirmed by the Conference Board of Canada. The City continues to forge a new relationship with the other orders of government which consists of a seat at the table (respect), greater legislative authority (power), and increased fiscal tools and sources (money).

The City began in 2004 to work with the Province in a joint task force to review the City of Toronto Act, which will become a single Act that effectively functions as the City's "constitution" and replaces the Municipal Act and other legislation that currently applies to the City. The financial objectives of the review include:

- making the City more fiscally sustainable
- equipping Toronto with the legislative tools it requires to thrive in a global economy
- improving the efficiency of the governments of Ontario and Toronto by eliminating duplicative, unnecessary and time-consuming measures.

The City of Toronto will continue to strive for improvements in financial controls and accountability, enhancements in the financial planning process and vigilance in fiscal prudence.

Joseph P. Pennachetti
Chief Financial Officer & Treasurer