Staff Report

To	**Committee of the Whole**
Service Area	Corporate Services
Date	Monday, February 3, 2020
Subject	**2020 Debt Management Policy Update**
Report Number	CS-2020-02

Recommendation

That the Debt Management Policy as recommended through report titled 2020 Debt Management Policy Update dated February 3, 2020 and numbered CS-2020-02 be approved.

Executive Summary

Purpose of Report

This report covers the results of an in-depth policy review focused on updating the City's Debt Management Policy. A policy is required to establish criteria for the use of debt within the City's overall financial framework. This policy demonstrates to investors that the City has strong financial management principles and it ensures continuity and consistency is applied to financial decision-making. Debt policies should be reviewed periodically to ensure continued appropriateness given changing market conditions and industry standards. The key policy items under review were:

- The appropriate ratios to measure debt and acceptable debt limits
- Criteria for debt funded projects
- The effectiveness of internal lending
- Frequency of debt issuance
- Reporting on debt to Council

Key Findings

The City has a strong Debt Management Policy that has supported the City's capital plan and helped maintain the strong AA+ credit rating for the past seven years. The current policy is in many ways aligned with the debt policies used by other municipalities in Ontario, however an update is required to ensure the policy reflects the City's Strategic Plan and today's economic environment.

The following changes to the Debt Management Policy are recommended in order to improve financial flexibility, reduce financial vulnerability and ensure the objectives of the Council-approved Strategic Plan are achievable in a financially sustainable manner:

- Increased utilization of internal lending
- Improved debt reporting
- Expand project eligibility to include infrastructure renewal projects

- Comprehensive set of ratios and caps to indicate the appropriate level of indebtedness

Financial Implications

Adopting the recommendations of this report will allow the City to balance existing fiscal strategies with new methods of measuring and adapting to changing markets. These recommendations ensure that the City's financial health will remain strong while also addressing the challenge of maintaining service levels, accommodating growth and adapting to changing legislation in an equitable and sustainable manner.

Report

Project Approach

This policy review followed a ten-step process:

1. Review current policy to determine how it aligns with economic conditions and corporate strategic goals.
2. Review legislation as it relates to municipal debt management in Ontario
3. Research academic and media reports on municipal debt management both in Canada and abroad
4. Distil goals and source of concern associated with current policy into questions for comparator municipalities
5. Survey comparator municipalities on their debt management policies and practices
6. Consolidate data from survey into key points, addressing both changes that the City can make and instances where Guelph was aligned with the current standard practice
7. Compare the compiled data with the goals and objectives found in the Strategic Plan
8. Synthesize the results of this research into a recommendation for policy change
9. Ensure policy aligns with the goals of the Long-term Financial Framework

Current Policy and Key Issues

The current policy is ten years old, having been established on October 26, 2009. Although this policy has generally served the City well, there is room to improve on certain key points. This policy emphasizes several sets of controls, and prioritizes the improvement of the City's credit rating, which has indeed gone from AA to AA+ in the intervening time.

The current policy contains several hard limits and sets of criteria for debt and debt issuance, including a list of factors, which a project must meet before debt can be considered, and several limits on overall debt, measured in different manners.

The policy is very comprehensive and lays out the different borrowing methods used for long-term, medium, and short-term debt, as well as many helpful 'structural features' such as debt denomination and repayment terms in section 7.

The challenges with the current Debt Management Policy relate to the rigidity of the guidelines that make compliance difficult given today's financial planning environment. In particular, the direct debt to reserve ratio target of 1:1 is difficult to maintain and is not a meaningful measure of financial health or creditworthiness. The Development Charge (DC) debt servicing to collections ratio does not align with the DC charge calculation methodology, so keeping within the targets identified is counterproductive.

One of the goals of the Debt Management Policy review is to evaluate the limits identified in the policy to ensure that the most appropriate ratios are being used to control the level of indebtedness and that the limits imposed are meaningful measures that balance financial flexibility and financial sustainability.

Attachment-3 reflects the current Debt Management Policy (2009) as approved in report FIN-09-35.

Legislated Framework

Legislative constraints are key when crafting financial policy in Ontario, as municipalities are under stringent controls and regulations. The purpose of this report is not to perform a legislative review, but the important restrictions have been listed here:

- Municipalities can incur debt for municipal purposes, including[1]
    - If authorized by another act to provide services jointly then municipalities can issue joint debt
    - For the purpose of a school board that falls within municipal borders, so long as the municipality is acting in accordance with the Education Act
- Municipalities can finance 'a work' in whole or in part by debentures so long as it has approved the issuance of debentures for the work.[2] These funds must be used for the work they were issued for[3]
- The municipality may authorize temporary borrowing at any time during the year, until taxes are collected, for any expense that they consider necessary to meet the needs of the municipality for that year
    - Between January 1 and September 30 this debt cannot exceed 50 per cent of the total estimated revenues of the municipality as set out in the budget.
    - Between October 1 and December 31 it cannot exceed 25 per cent of the total estimated revenue of the municipality.[4]
- Debentures can only be issued for long-term borrowing so long as they are providing financing for a capital work.[5] They also shall not exceed the useful life of the capital work and under no circumstances shall they exceed 40 years.[6]
- Municipal debt is limited by the annual repayment limit (ARL), which is the maximum that a municipality can pay in principal and interest payments in one

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[1] *Municipal Act, 2001* S.O. 2001 c.25 s. 401(1) (Ontario)

[2] *Municipal Act, 2001* S.O. 2001 c.25 s. 405(1)(a) (Ontario) – as municipal actions must be authorized by bylaw this is no exception, council must pass bylaws to approve each issuance of debt for a work

[3] *Municipal Act, 2001* S.O. 2001 c.25 s. 405 (2) and s.413 (Ontario)

[4] *Municipal Act, 2001* S.O. 2001 c.25 s. 407(2)(a)(b) (Ontario)

[5] *Municipal Act, 2001* S.O. 2001 c.25 s. 408(2.1) (Ontario)

[6] *Municipal Act, 2001* S.O. 2001 c.25 s. 408(3) (Ontario)

year; this is determined by the Ministry of Municipal Affairs and Housing (MMAH) for each municipality in Ontario.[7] Typically, the ARL for most municipalities is 25% of the municipality's annual own source revenues, less their annual long-term debt servicing costs and annual payments for other long-term financial obligations[8]

Survey Results

The municipalities contacted during this survey were:

Group 1	**Group 2**
London	Pickering
Brantford	Orillia
Kingston	Peterborough
Ottawa	York Region
Windsor	Kitchener
Thunder Bay	Ottawa
Chatham-Kent	
Barrie	
Hamilton	

These municipalities fall into two categories, Group 1 which are municipalities similar to the City of Guelph, based on a balance of factors including population, location, and corporate structure, while Group 2 are municipalities with unique perspectives on issues affecting municipal debt.

Performing interviews led to an abundance of data that both confirmed some of the City's current practices and gave insight on where the City can improve.

Many of the common practices around the province, such as having an official debt management policy, are consistent with our existing practices. Additionally, in constructing this survey, we sought to find ways that other municipalities surpass our practices so that we could implement these measurements, metrics and caps. The questions asked in this survey focused on:

- Whether or not municipalities maintain an official debt policy
- Their reserve lending practices
- Criteria applied to determine whether projects can be debt funded
- What types of debt the municipality uses
- Debt limits and ratios used by the municipality to maintain financial health

[7] *Municipal Act, 2001* S.O. 2001 c.25 (Ontario)

[8] Ministry of Municipal Affairs and Housing. "Understanding Municipal Debt." *Ontario.Ca*, 23 Sept. 2019, www.ontario.ca/document/tools-municipal-budgeting-and-long-term-financial-planning/understanding-municipal-debt.

- Whether they have restrictions on the amortization periods they find acceptable
- The frequency with which debt is issued
- DC debt practices and ratios that are used specifically for DC debt
- Methods of reporting debt to Council

In many ways, the survey results emphasized that Guelph has excellent financial management practices. However, there are also opportunities for improving the status quo.

Through discussions with representatives of each of these municipalities, and reviewing their debt management policies provided a clear picture of the current industry standard in Ontario that has emerged. Ontario municipalities tend to behave in a manner similar to the City, which values flexibility and responsiveness in their financial policies, but balances this with prioritizing the requirements of credit rating agencies such as Standard & Poor's (S&P) or Moody's.

Some of the consistent findings across Ontario municipalities are:

- Typically most municipalities have a codified debt management policy
- Most Ontario municipalities engage in internal financing, typically they charge themselves interest at market or a rate equivalent to Infrastructure Ontario
- Most Ontario municipalities do not institute hard criteria for which type of projects can be debt funded, most prefer a flexible case-by-case approach where staff and Council can judge each project on its merits
- About half of the municipalities surveyed have a self-imposed debt limitation that is lower than the provincial requirements, however, the caps themselves vary a great deal and there appears to be no standard limit
- Although many municipalities monitor their debt-to-reserve ratio most do not have a stated goal. Those that do use the industry standard of 1:1
- Most municipalities determine the amortization period of their loans based on provincial regulations rather than setting their own internal limits
- Municipalities typically issue debt annually, sometimes skipping a year if it is not necessary
- Most municipalities report debt to Council using the annual budget process

Although many of these practices are consistent with the City's current policy, it has helped to inform staff of where the City can improve their current financial management strategy.

Academic Results

This review involved extensive research on academic and Non-Governmental Organizations (NGOs)[9] advice for municipalities and local governments managing their debt. While it is difficult to find a set of cohesive recommendations from this research, as it spanned many countries and regulatory frameworks, some common themes emerged. It is a commonly held truth that particularly in the face of increased downloading of services to local governments, debt is necessary and healthy for a municipality trying to meet their growing needs and address the infrastructure gap. Almost unanimously the advice leans towards creating a set of indicators and ratios that allow the local government to control debt in a way that is

[9] This includes organizations such as the Government Finance Officers Association, the International Monetary Fund and the World Bank

prudent for their situation without unnecessarily constraining government action. Additionally, most sources agree that local governments who choose to rely on debt should prioritize protecting their credit rating. The prevailing advice is to set constraints and indicators that will keep the municipality from overspending and taking out excessive debt during growth periods, while also maintaining flexibility so they can appropriately respond to crisis.

This is a brief summary of the findings; however, the full findings can be obtained from staff.

Findings and Recommendations

Internal Lending

Current Policy

The City's policy on internal lending is in line with the industry standard in Ontario. It allows for internal lending from one reserve fund to another so long as it will not adversely affect the intended purpose of the lending reserve fund.

The City's current policy comprehensively lays out the benefits of this practice, including increased flexibility of being able to set its own loan terms, lower costs of interest (as all interest is returned to the City rather than being paid to a third party lender), and savings in legal and fiscal agent fees. Despite this, the City has not taken advantage of the internal lending option to the extent that it could; having only internal borrowed once in 2014. The City does informally lend between reserves and reserve funds in that "like" reserve and reserve funds are managed in total and any negative balances are required to provide interest at the City's actual annual investment rate of return.

This use of internal debt in 2014 was a good learning experience and was approved to temporarily bridge an external debenture by borrowing from the Water and Wastewater Capital Reserve Funds for the Wellington-Dufferin-Guelph Public Health facilities, Baker Street land acquisition, Solid Waste carts and the Hanlon/Laird interchange. The term of the internal loan was two years and paid a rate of return of 2.3% (based on the expected rate of return on the City's investment portfolio for that period). External debentures in that same timeframe were costed at 2.75%, representing a $148 thousand savings in interest payments over the term of the loan.

Legislation

The Provincial legislation mandates the City to maintain certain reserves and reserve funds, however there are no restrictions in place relating to internal reserve lending.

Academic and Survey Results

Internal lending has not attracted a great deal of interest from academics or credit rating agencies. However, in speaking to other Ontario municipalities it is clear that internal lending is widely practiced. Almost all municipalities who engage in this practice charge themselves interest on these internal loans to compensate the lending reserve fund for the lost interest revenue they would have otherwise received.

Most municipalities do not have policies that limit the use or term of the internal lending, however, survey respondents indicated it is typically used for short-term borrowing only.

Internal lending is in-line with one of the recommendations that the World Bank makes for local governments in their 2017 book Municipal Finance: a Handbook for Local Governments, which recommends municipalities pursue creative alternatives to debt when seeking to maintain good financial health.[10]

Municipalities typically do not have additional accounting methods of addressing the complications that come with internal borrowing. It can present difficulties, as it does not show up on a balance sheet the same way a regular loan does. It is recommended by representatives from Pickering and Orillia, that all internal loans be accompanied by a promissory note signed by the Treasurer which lays out the terms of the loan. Although these notes are somewhat duplicative of the authorization by-laws passed by Council, they can assist with accounting principles and with keeping the terms of the loan in a concrete and accessible form that is easy for everyone to view.

Unanimously, municipalities who engage in this practice stated that it had not had an effect on their credit rating. Despite the fact that this practice does not have academic or rating agency data backing it up, it appears to be a new standard practice. These short-term loans can be used when cash flow is sufficient and to prevent the issuance of small debentures, which may not be optimal for marketing.

Recommendation

While the current policy allows for the use of internal lending, there has only been one formal lending arrangement in the last ten years. Municipal survey results have revealed that internal lending is becoming increasingly more common due to the benefits relating to: savings in debt servicing costs, added flexibility, and funding solutions for short-term funding needs. It would be advisable to employ internal lending more frequently in the capital planning process, using improved authorization guidelines to improve consistency and continuity. When the amount being loaned exceeds $1 million the formal process should be followed, for lesser amounts the section regarding interest rate applicable will still apply.

Frequency of Issuance

Current Policy

The current Debt Management Policy does not set out a specific time frame for the frequency of issuing debt. However, the City's current practice is to issue debt as needed, in accordance with the debt continuity schedule that forecasts debt-funded projects and debt needs over the long-term.

Legislation

There are no regulations or legislation to dictate how frequently municipalities can or should issue debt.

[10] D. Farvacque-Vitkovic, Catherine, and Mihaly Kopanyi. *Municipal Finances: A Handbook for Local Governments*. World Bank Publications, 2014.

Academic and Survey Results

Most municipalities report that they issue debt as needed or issue it annually. Issuing annually allows municipalities to isolate themselves from economic fluctuations and avoid being forced to issue debt in an unfavourable market.

The frequency that a municipality issues debt is not a measurement that S&P uses to gauge municipality's financial health, as long as the issuance was planned and within the corporate thresholds, it will not have an impact on the credit score.

Recommendation

It is recommended that the City maintain the current approach to issuing debt as needed and planned through the capital budget forecast. Increasing the utilization of internal borrowing may extend the timeframes required for issuing external debt as well.

Council Debt Reporting

Current Policy

The current policy does not specifically address the way that debt is reported to Council. Debt is typically addressed through the budget process or when Council authorizes each individual debt issuance. Further, there is annual debt reporting through the audited financial statement presentations to Council. Debt plays a key role in the achievement of Council-directed strategic goals and is an important indicator of financial health. Improved debt reporting to Council and stakeholders will provide greater context to the capital budget discussion and contribute to more informed decision-making.

Legislation

There is no legislation or regulation that dictates how debt is communicated to Council. However, under provincial legislation all municipal actions must be taken by way of a by-law, including each instance of debt issuance.

Academic and Survey Results

Most municipalities in Ontario take a similar tactic as the City, debt is presented through the budgeting process or through the individual by-laws that Council passes. However, several municipalities employ additional communication tools to assist staff and Council in remaining consistent in their interpretation about debt and financial practices. Two of the surveyed municipalities engage in a 'bird's eye view' presentation of the municipality's finances about a month before the budget is prepared, including a section on debt. Additionally, one municipality employs a 'debt fact sheet' that is also distributed prior to preparing the budget in order to ensure that staff and Council are aware of the current state of the municipality's finances. Please find as Attachment-2 - Municipality of Chatham-Kent – Debt Fact Sheet the annual debt fact sheet used by the Municipality of Chatham-Kent.

Recommendation

Although the current approach is adequate, there are several alternate methods that municipalities engage in which could be used to further Council's understanding of the City's debt situation. The recommended options include:

- A debt management fact sheet that lays out the current state of the City's finances, as part of the Annual Financial Statements

- A bird's eye view of the City's finances presented to Council just prior to budget season every July
- A dedicated finance presentation to Council with several slides dedicated to debt, as part of the annual budget presentation

Criteria for Debt Funded Projects

Current Policy

The City currently has an extensive list of criteria that a project must meet before it is eligible to be funded by debt:

- the individual project value exceeds $500,000
- the estimated useful life of the asset is greater than 10 years
- the project has been approved by Council as part of the annual capital budget and has been clearly identified as being funded by debt
- it is an appropriate means to achieve a fair allocation of costs between current and future beneficiaries or users
- the project is supported by a comprehensive business case including
    - total cost of the project
    - cash flow of the project including debt issuance
    - operating costs after completion of the project
    - benefits to the community
- funding cannot be accommodated within the tax or rate supported capital budget, and other internal sources (such as borrowing from reserve funds) and external sources (such as senior government grants and subsidies, private / public partnerships, or user-pay systems) have been thoroughly investigated
- the issuance cannot be used to fund current operations

It is the City's current policy to only use debt funding for growth-related projects and City building projects. All infrastructure renewal projects are to be funded on a pay-as-you-go approach. This is a challenge as the City's infrastructure is aging and replacement needs put significant pressure on the tax and rate supported reserve funds. More flexibility is needed to accommodate projects that need to be moved forward.

Legislation

Municipalities are permitted to take on short-term debt of under one year in order to finance operating costs; the exact amounts they are permitted to finance using this type of debt is dependent on the point in time in the fiscal year.[11]

Academic and Survey Results

Of the municipalities surveyed for this report, most did not use a set of specific criteria to determine which projects were permitted to take on debt, with the exception of not allowing debt for operational costs, which is a universal practice. Throughout the survey, this held true for both: what portion of the project needed to be funded before considering debt, and criteria for individual projects and restrictions of debt by asset class. One of the municipalities surveyed currently has a minimum threshold for internal funding which a project must meet before debt can be used. However, they are finding this practice unnecessary and are seeking

[11] *Municipal Act, 2001* S.O. 2001 c.25 s. 407(2)(a)(b) (Ontario)

to reconsider it shortly. The policy is unnecessarily restrictive and does not serve the intended purpose, as those surveyed observed that there is no functional difference between having three projects that are 30% debt-funded and one project that is 100% debt-funded. None of these measures for restricting debt to only certain projects are popular in Ontario. Most municipalities take a project-by-project based approach where the appropriateness of debt can be determined between Council and staff. This flexible option allows staff and Council the freedom to judge each debt issuance on its individual merits and weight it against the City's current financial situation and strategic goals, which may have changed a great deal after the initial policy decisions were made.

Many of the municipalities surveyed do make a habit of waiting until a substantial portion of work has been started, or even completed before issuing debt. This is not typically codified in their policies but most feel it is a more prudent strategy to fund projects through reserve funds and then reimburse the reserve funds using debt.

Recommendation

The criteria in the new policy should be updated to reflect the following changes:

- Allow debt to be used for significant infrastructure renewal projects to improve the City's ability to respond to replacement needs as they arise.
- The threshold requirements should be increased to $5,000,000 per project, and the useful life of the asset should not be less than 20 years.
- Special circumstances may require issuance of shorter life assets where the quantity or value dictates, these will be identified as approved.

Appropriate Debt Ratios and Limitations

Current Policy

The City's current policy has four limitations:

1. Direct debt as a percentage of operating revenue not to exceed 55%
2. Debt servicing costs should not exceed 10% of operating revenues
3. DC debt servicing should not exceed 20% of the average revenue forecast from the DC Background Study for non-discounted services and should not exceed 10% for all other DC reserve funds
4. 1:1 direct debt to reserve ratio

Legislation

Legislated limitations prohibit municipalities from running a deficit and over-leveraging their financial position. Municipalities may not borrow to fund operating costs, beyond the end of their fiscal year. Additionally, municipalities are obligated to keep their borrowing under the ARL. This debt limit is set by the province for each municipality and sets the maximum amount that a municipality can pay in principal and interest that year. This limitation is 25% of the municipality's own source revenue.

The legislation states that the amortization period for debt is limited to the expected life of the asset and absolutely limited at 40 years.[12]

[12] *Municipal Act, 2001* S.O. 2001 c.25 s. 408(3) (Ontario)

The MMAH recommends that municipalities use the following for monitoring their own debt:

- Debt charges per capita
- Debt charges as a percentage of revenue
- Debt charges as a percentage of municipal levy

The MMAH advises that these ratios can be monitored using data taken from the annual Financial Information Return (FIR) reports to compare these ratios with others around the province.

Academic and Survey Results

Most municipalities surveyed do not have limitations on debt other than the ARL. However, it is likely prudent to have one, as it is a metric looked at by credit rating agencies and there are no adverse effects reported by the municipalities that do have them.[13]

In the 2017 book "Financial Policies"[14] published by the Government Finance Officers Association (GFOA) it is recommended that when determining appropriate debt ratios, the first step is to consider the indicators that will be used. The two main types are (1) ratios that measure the budgetary impact of debt and (2) the ratios that measure the community's ability to support debt. Once the measurements have been chosen, then the appropriate level can be determined by balancing financial health with organizational goals.

One of the key indicators that was reassessed during this survey was the use of the 1:1 debt to reserve ratio. This is the ratio that the City currently uses to measure the amount that should be held in reserve. Many of the municipalities surveyed used a variation of this measurement. The International Monetary Fund similarly endorses it[15] for use by national and regional governments. However, the manner in which it has been applied by the City does not align with the way it is employed by credit rating agencies and other municipalities. A more robust financial picture emerges when looking at other similar indicators, which help determine the amount that should be held in reserve.

The City's credit rating agency, S&P, evaluates credit worthiness through a weighted assessment of six factors; institutional framework, economy, financial management, budgetary performance, liquidity, debt burden (see Table A: Breakdown of City's Credit Rating Score). Total debt-to-operating revenues and debt servicing-to-operating revenues are the key indicators to determine the 'score' for debt.

[13] Some municipalities have noted that they find it difficult to comply with their debt caps. These caps are typically in the 7-15% range, suggesting that a higher limitation is more appropriate

[14] Kavanagh, Shayne, and Government Finance Officers Association. *Financial Policies*. Government Finance Officers Association, 2012.

[15] Standard and Poors Financial Services LLC. "Methodology for Rating Local and Regional Governments Outside of the U.S." *S&P Global Ratings*, 2019, pp. 1–18.

Table A: Breakdown of City’s credit rating score

Key Rating Factors	City’s score 2019 (1 is highest, 6 is the weakest)
Institutional Framework	2
Economy	1
Financial Management	2
Budgetary Performance	2
Liquidity	1
Debt Burden	1

The City’s direct debt-to-operating revenue ratio is 22.6% in 2018 and the debt servicing-to-operating revenue ratio is 4%. Based on the criteria above, S&P determined that the City’s credit score is an AA+. The review board cautioned that the rating could be downgraded if the City were to pursue an aggressive capital plan absent of operating revenue growth sufficient to prevent a material erosion of operating balances, large after-capital deficits and a tax-supported debt burden greater than 30%. Table B: Assessment of a Local and Regional Government’s Debt Burden illustrates how the debt indicators (total debt-to-operating revenue and debt servicing-to-operating revenue indicators) inform the score for debt burden. It is important to note that there is not just one debt ratio considered in isolation when determining the credit rating score. The credit rating metric evaluates debt-related indicators in combination with liquidity levels, operating revenues and capital expenditures.

Table B: Assessment of a Local and Regional Government’s Debt Burden

Interest as a % of Operating Revenue	Tax-supported debt as a percentage of operating revenue <30%	Tax-supported debt as a percentage of operating revenue 30<60%	Tax-supported debt as a percentage of operating revenue 60<120%	Tax-supported debt as a percentage of operating revenue 120<240%	Tax-supported debt as a percentage of operating revenue 240% and above
<5%	1	2	3	4	5
5%-10%	2	3	4	4	5
>10%	3	4	5	5	5

If the City were to exceed the 30% total debt-to-operating revenue ratio, the score would shift from ‘1’ to ‘2’ which would have a negative impact on the overall rating, ceteris paribus.

Recommendations

1. Debt servicing costs should not exceed 10% of operating revenues

Debt servicing as a percentage of operating revenue measures the relative cost of debt to the City’s budget and inversely indicates the level of funding available to provide programs and services. Maintaining a cost of less than 10% will ensure a strong credit rating score and an appropriate allocation of resources to the provision of programs and services.

2. Direct debt as a percentage of operating revenue not to exceed 55%

The credit rating review agencies consider the total debt to consolidated operating revenues as the most appropriate measure for international comparisons. Staff are recommending that this be set as a hard limit of 55%.

3. DC debt servicing not have prescribed limit, instead DC debt be limited as part of the overall the total debt to operating revenue ratios.

In the previous Debt Policy, DC debt servicing was limited to not exceed 20% of the average revenue forecast from the DC Background Study for non-discounted services and 10% for all other DC reserve funds. This was put in place because DC cash flows are considered to be higher risk due to the reliance on external factors to generate the revenues. The City’s Debt Management Policy should aim to protect the City from undue risk associated with fluctuations to the development industry and changes to the DC legislation, while providing the flexibility to achieve the growth-related goals of the City. To this end, staff are recommending managing the use of debt for DC projects on a service-by-service basis, ensuring that the expectations regarding level and rate of growth are appropriate for the level of debt required for asset financing. There are several major debt-funded projects identified in the 2018 DC Background Study, these have been reviewed and are deemed to fit this criteria. To support and compliment the DC Background Study the City is working to develop a Growth Costing Policy which will assist in establishing appropriate levels of debt related to growth including DC debt.

4. 1:1 outstanding debt to reserve and reserve fund balance ratio

Total debt to reserves and reserve funds is an indicator measured and reported by most municipalities, even if they do not officially enforce a limit.

The International Monetary Fund has stated that the benchmark of 1:1 for general government debt, not specifically municipalities, is useful but limited. They recommend that it should be supplemented with location specific indicators that can more clearly indicate the government’s liquidity, income streams and ability to manage in crisis.[16]

The current policy recommends a ratio of 1:1; however, this rigid standard may not be appropriate given the capital forecast and the long-term funding strategy over the next 20 years.

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[16] International Monetary Fund. “Debt and Reserve Related Indicators of External Vulnerability.” *IMF.Org*, Mar. 2000, www.imf.org/external/np/pdr/debtres.

5. Debt servicing costs to reserve and reserve fund balance ratio of 14:1 (minimum)

When measuring financial health and creditworthiness, S&P evaluates the level of liquidity against expenses and debt servicing costs in particular. It is recommended that 12 months of debt servicing costs be available in the discretionary reserves and reserve funds. This is a best practice supported by the World Bank's recommendation to have on hand the funds to service several months of debt.[17]

It is recommended that the Debt Management Policy use the discretionary reserve and reserve funds to debt servicing costs ratio to indicate how many years the City could pay for debt serving obligations in the absence of new revenue. The City's current ratio is 16:1 before commitments, which supports the highest possible score for liquidity in the S&P credit rating evaluation.

6. Debt per capita and Debt per Assessment Value

The measure of the community's ability to support debt is important for the broader financial condition for the City. Both the Debt per capita and Debt per Assessed Value are good indicators of the community's ability to meet debt obligations and will be calculated and reported to Council on an annual basis.

Financial Implications

Adopting the recommendations of this report will allow the City to balance fiscal strategies with new methods of measuring and adapting to changing markets. These recommendations ensure that the City's financial health will remain strong while also rising to the challenge of maintaining service levels, accommodating growth and changing legislation in an equitable and sustainable manner.

Long-term Financial Framework alignment

This policy aligns with the three pillars of the Long-term Financial Framework as per the below items, these ensure that this policy will guide strategic decision making that is aligned with the City's long-term financial strategy.

Sustainability – Targeted percentage of revenue

Vulnerability – Maximum percentage leveraged

Flexibility – Prescribed purposes and types

Consultations

Survey of comparator municipalities

Strategic Plan Alignment

The policy statement in the Debt Management Policy has been updated to reflect the priorities of the new Strategic Plan.

"Ensure adequate infrastructure, services and resources to support existing and growing communities", aligns with the Building Our Future priority and,

[17] D. Farvacque-Vitkovic, Catherine, and Mihaly Kopanyi. *Municipal Finances: A Handbook for Local Governments*. World Bank Publications, 2014.

"That new debt be planned at a level which will optimize borrowing costs and not impair the financial position of the City" aligns with Working Together For Our Future priority.

Attachments

Attachment-1 – 2020 Debt Management Policy

Attachment-2 - Municipality of Chatham Kent – Debt Fact Sheet

Attachment-3 – 2009 Debt Management Policy

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Corporate Policy and Procedure

Policy	**Debt Management Policy**
Category	Finance
Authority	Council
Related Policies	General Reserve and Reserve Fund Policy, Investment Policy
Approved By	Council
Effective Date	Sunday, March-01-2020
Revision Date	Each term of Council

1. Policy Statement

It is the policy of the City of Guelph to

- Ensure adequate infrastructure, services and resources to support existing and growing communities
- Ensure new debt be planned at a level which will optimize borrowing costs and not impair the financial position of the City
- Ensure debt is structured in a way that is fair and equitable to those who pay for and benefit from the underlying assets over time

2. Purpose

The purpose of this debt management policy is to

- Establish financial guidelines and appropriate benchmarks for the issuance and use of debt in the City of Guelph
- Ensure long-term financial flexibility and sustainability
- Limit financial vulnerability
- Integrate with other long-term planning, financial and management objectives of the City
- Assist with ensuring that the municipality maintains a sound financial position and that the worthiness of the City's credit rating is protected
- Ensure that the City's financial practices comply with statutory requirements

3. Definitions

Annual Repayment Limit

Under Regulation 403 /02: Debt and Financial Obligation Limits, this limit represents the maximum amount which the municipality has available to commit to payments relating to debt and financial obligations without seeking the approval of the Ontario Municipal Board (OMB). This limit is provided annually to a municipality by the Ministry of Municipal Affairs and Housing (MMAH), additionally this limit must be updated by the City Treasurer prior to Council authorizing any increase in debt-financing for capital expenditures.

Business Case

An analysis that demonstrates the necessity for and viability of a new project. A business case will include a financial analysis and a financial plan that identifies and confirms sources of funding to provide for the financial plan that identifies and confirms sources of funding to provide for the financing of the capital and operating costs of a new project.

Capital Expenditure

An expenditure incurred to acquire develop renovate or replace capital assets as defined by the Public Sector Accounting Board (PSAB), section 3150.

Debenture

A formal written obligation to pay specific sums on certain dates. In the case of a municipality, debentures are typically unsecured i.e. backed by general credit rather than by specified assets.

Debt

Any obligation for the payment of money. For Ontario municipalities, debt would typically consist of debentures as well as either notes or cash loans from financial institutions. Could also include loans from reserves or reserve funds. Debentures issued to Infrastructure Ontario are also considered debt.

Debt Service Costs

Debt repayments, including interest and principal (per FIR 74-3099).

Development Charge (DC) Collections

Charges collected from new development, at building permit issuance to help fund the cost of infrastructure required to accommodate growth.

Development Charge (DC) Debt

Debt issued for Council-approved growth related infrastructure, identified in the Development Charge (DC) Background Study, to be repaid exclusively with DC collections.

Direct Debt

Means the total debt burden of the City (per FIR 74-9910). It includes all debt issued by the City and consolidated entities less all debt assumed by others.

Flexibility

The ability of the City to issue new debt in response to emerging financing needs.

Financial Information Return (FIR)

Data collection reports providing statistical information on municipalities, as provided by the MMAH.

Infrastructure

Large-scale public systems, services, and facilities of the City that are necessary for economic activity in the community, including water and wastewater systems, roads, and buildings / facilities.

Internal Funding

Funding provided from one City reserve fund to another, to fund specific short-term projects. These funds will be repaid from the receiving fund to the lending fund in accordance with a promissory note.

Non-tax Supported Debt

Debt issued for capital expenditures related to non-tax supported operations. This debt is repaid using net revenue fund revenues.

Non-tax Supported Operations

Municipal services that are funded through water, wastewater and stormwater rate revenues.

Operating Revenue

Total revenue fund revenue per line 9910 of FIR schedule 10 less other revenue (10-1899), less grants received (10-0699 and 10-0899), less revenue from other municipalities (10-1099).

Own-Source Revenue

Revenue for a fiscal year, excluding:

a) grants from the Government of Ontario or Canada or from another municipality;

b) proceeds from the sale of real property;

c) contributions or net transfers from a Reserve Fund or reserve;

d) Government of Ontario revenues received for the purpose of repaying the principal and interest of long-term debt, toward meeting financial obligations of the municipality; and

e) other municipality or school board receipts for the purposes of repayment of the principal and interest on long-term debt of the municipality borrowed for the exclusive purpose of the other municipality or school board.

Promissory Note

To enable the use of internal funding Council will authorize a promissory note which will lay out the terms of the loan, including amount, length of time, and rate of interest.

Sustainable

Meeting present needs without compromising the ability to meet future needs.

Statutory Annual Debt Repayment Limit

The annual debt and financial obligation limit for municipalities as described under Ontario Regulation 403/02. The regulation provides a formula which limits annual debt service costs to an amount equal to 25% of operating revenue.

Tax Supported Debt

Debt issued for capital expenditures related to tax supported operations. This debt is repaid using net revenue fund revenues.

Tax Supported Operations

Civic programs that are funded through net revenue fund revenues, such as roads, transit, and parks.

Term Loan

A short-term loan which is repaid in regular instalments over a set period of time, as laid out in the enabling documents.

4. Statutory Requirements

Capital financing may only be undertaken if and when it is in compliance with the relevant sections of the Municipal Act, the Local Improvement Act, or the Tile Drainage Act, and their related regulations. These requirements include, but are not limited to:

- The term of temporary or short-term debt for operating purposes will not exceed the current fiscal year;
- The term of capital financing will not exceed the lesser of 40 years or the useful life of the underlying asset;
- Long-term debt will only be issued for capital projects;
- The total annual financing charges cannot exceed the Annual Repayment Limit (ARL), as applicable, unless approved by the OMB;
- Prior to entering into a lease financing agreement, an analysis will be prepared that assesses the costs as well as the financial and other risks associated with the proposed lease with other methods of financing;
- Prior to passing a debenture by-law which provides that installments of principal or interest, or both, are not payable during the period of construction of an undertaking, Council will have considered all financial and other risks related to the proposed construction financing.

5. Purposes for Which Debt May Be Issued

The City may borrow by debenture, mortgage or other acceptable debt instrument to finance capital expenditures that support corporate priorities and approved strategic plan, while using the following guidelines to determine on a case-by-case basis whether the use of debt is appropriate:

- Whether the individual project value exceeds $5,000,000
- Whether the estimated useful life of the asset is greater than 20 years
- Whether the project has been approved by Council as part of the annual capital budget and has been clearly identified as being funded by debt
- Whether it is an appropriate means to achieve a fair allocation of costs between current and future beneficiaries or users
- Whether the project is supported by a comprehensive business case
- The total cost of the project
- The cash flow of the project including debt issuance

- The operating costs after completion of the project
- Funding of the capital expenditure cannot be accommodated within the tax supported capital budgets, rate supported capital budgets, development charge capital budgets, and other internal sources (such as borrowing from reserve funds) and external sources (such as senior government grants and subsidies, private / public partnerships, or user-pay systems) have been thoroughly investigated
- A sustainable funding source has been identified

The City will not use long-term debt to fund current operations.

6. Limitations on Indebtedness

6.1 Statutory Limitations –ARL

The 2020 ARL is based on the City’s 2018 FIR. The City is not allowed under Provincial regulation to issue debt which would result in the annual repayment limit being exceeded without OMB approval.

6.2 Self Imposed Limitations

Notwithstanding the limits prescribed in the regulations, prudent financial management calls for more stringent criteria to limit debt. These criteria will assist in preserving borrowing capacity for future capital assets while maintaining maximum flexibility for current operating funds. See Attachment A for details of calculations.

6.2.1 Direct Debt to Operating Revenue

This measure identifies the percentage of annual operating revenues that would be required to retire the City’s net debt. It is also the prime measure used by Standard and Poor’s when assessing the debt burden of the municipality. A target rate of less than 55% should be maintained.

6.2.2 Debt Service Cost to net Revenue Fund Revenue

This ratio is a measure of the principal and interest payable annually as a proportion of revenue fund revenues. It should not exceed a target of 10%.

6.2.3 Debt Servicing to Discretionary Reserve Ratio

This ratio is used to determine how many years the City could pay for debt servicing obligations in the absence of new revenue. A target of 14:1 should be maintained.

6.2.4 Development Charge (DC) debt assessment

This assessment will be used to ensure that each approved DC service that requires debt is able to provide sustainable cash flows and the ability to collect sufficient funds to retire the debt.

7. Types of Debt

7.1 Short-term (Under One Year)

Interim financing for capital assets pending long-term capital financing, may be accommodated though internal funding (see section 8.2 and 11.3)

7.2 Medium-term (One – Four Years)

Medium-term financing requirements, for periods greater than one year but less than five years will be financing through any one or combination of the following. The financial commitments for existing and anticipated leases for the current fiscal year are to be included in the calculation of the City's financial debt and obligation limit.

- Internal funding
- Term loan

7.3 Long-term

Long-term debt consists of debentures or other form of debt issued to the City to finance assets over a period of not less than five years and not more than 40 years. Options include:

- Municipal serial or amortized debentures
- Long-term bank loans if deemed cost effective. These loans may be fixed or variable interest rate loans as determined by the Treasurer

8. Methods of Marketing/Selling Debenture Issues

8.1 External Debenture securities may be sold by the following means:

a) Debt issuance syndicate. The use of a debt issuance syndicate will be the normal method by which debentures will be sold by the City; or

b) Tender. A tender process may be used when and if significant savings could be expected when compared to issuing through a debt issuance syndicate.

8.2 Internal Funding

The City has the general power pursuant to section 417 of the Municipal Act, 2001, SO 2001, c. 25 to apply reserve funds to a purpose other than that for which the fund was established. This includes the making of an internal loan from reserve funds in order to finance capital projects of the City. When the value of internal loan exceeds $1 million a formal process is required as prescribed here. In all other cases the rate of interest payable is to be calculated the same as prescribed here.

The municipality may elect to borrow from internal sources using reserve funds, provided that excess funds are available and the use of these funds will not impact the reserve funds current operations. Internal reserve borrowings will pay a variable interest rate to the lending reserve/reserve fund, based on the annual average rate of return on investments and will be evidenced by documentation as required by legal services, including repayment schedule.

When an analysis of the reserve or reserve fund has determined that excess funds are available and that the use of these funds will not adversely affect the intended purpose of the reserve or reserve fund, the City's reserve funds may be used as a source of financing for short to long-term purposes. The reserves will be repaid with interest at a rate based on the actual annual average balance of the reserve fund and the City's rate of return on investments.

9. Structural Features

9.1 Debt Denomination

The City shall issue debt denominated in Canadian dollars only.

9.2 Fixed Interest

The City shall issue general obligation debt with a fixed rate of interest. Interest rate swap agreements may be used to exchange floating-rate interest payments for fixed-rate interest payments.

9.3 Repayment Terms

The repayment term will be dependent on the useful life of the asset being acquired by the City, and should not exceed 40 years.

9.4 Debt Structure

9.4.1 Debt shall be structured in a manner that provides a fair allocation of costs to current and future users.

9.4.2 Debt shall be structured to achieve the lowest possible net cost to the City given market conditions, the type of debt being issued, and the nature and type of the repayment source.

9.5 Repayment

9.5.1 Unless otherwise justified and deemed necessary, the repayment schedule should be structured on a level or declining payments basis.

9.5.2 Early repayment of debt may be considered if it is financially beneficial to do so.

10. Credit Objectives

10.1 Credit Rating

The capital financing program will be managed in a manner to maintain an adequate credit rating by a credit rating agency used by the City (e.g. Standard and Poor's, "AA+" rating).

A key element of maintaining an adequate credit rating will be to ensure that the timing, amount and type of capital financing will be assessed as being appropriate to the long-term needs of the City as well as being seen as balanced against other forms of financing.

Particular attention shall be paid to the key indicators used by credit rating agencies as part of the debt management process in order to maintain the City's credit worthiness, including:

- Debt to operating revenues
- Debt servicing costs as a percentage of own source revenues
- Liquidity
- After capital balances
- Other long-term liabilities

11. Authorization

11.1 Approval Funding for Capital Projects

The approval to fund an eligible capital project by debenture will generally be sought through the annual capital budget process. The funding of emerging strategic priorities outside of the traditional budget process shall be approved by specific by-law.

11.2 Debenture Issue

Each debenture issue shall be approved by specific by-law of Council including the term, rates of interest, debt servicing obligation, and general terms of issue.

11.3 Internal Borrow

Each such loan is to be authorized by a specific by-law passed by Council and set out the amount, interest, term of the loan, and the specific reserve or reserve fund from which the loan is made. Borrowing in this manner offers several advantages over traditional debenture financing including the following:

- Increased flexibility in setting loan terms,
- Lower interest cost, and
- Avoidance of legal and fiscal agent fees.

For the approval of each internal loan the specific details must, at a minimum, include the following:

- Start date
- Loan type
- Loan amount
- Loan period
- Loan rate
- The loan rate will reflect the City's all-in cost of funding for a similar term and structure at the time of the actual loan, as determined by the Treasurer
- Repayment frequency
- Legal Documentation

Upon full approval, legal services must be consulted to determine the appropriate legal documentation required between the lender and the borrower.

The legal documentation must include:

- The resolution number and date of the associated Council report
- The specific details of the internal loan as agreed to by the Treasurer
- The Deputy Chief Administrative Officer of the requesting department must provide sign-off of the loan request

11.4 Calculation of Debt Limitation Ratios

The Treasurer shall have authority to modify the calculation of the prescribed debt limit ratios as set out in Appendix A via notification to Council, in so far as changes in the FIR or other related schedules and statements is required.

12. Administration

12.1 When Borrowing Will Occur

The borrowing to finance capital projects will normally occur once the projects are essentially completed.

12.2 Issuance Costs

When feasible, debt issuances will be pooled to minimize issuance costs.

13. Reporting Requirements

13.1 Reports to Council

The Treasurer shall submit to Council, at a minimum annually, a report that provides:

- Total debt outstanding
- Annual principal and interest payments
- Report debt ratios as prescribed in section 6 above, forecasted over 25 years
- Forecasted debt issuance over the 10 year horizon
- Debt per Capita ratio

- Debt per Assessment Value

14. Policy Review

This policy will be reviewed with each new term of Council.

Appendix A – Method of calculation of self-imposed limitations

For ratios calculate using the FIR, the number shown is the schedule –line combination, e.g. 10-9910,1 is Schedule 10 line 9910 column 1

6.2.1 Direct Debt to Operating Revenue

Calculated using the annual FIR as Debt Outstanding/Net Operating Revenue

FIR Cell	Description	Amount
70-2010,1	Temporary Loans	-
74A-0299,1	Total Outstanding Debt	92,963,691
74A-0499,1	Debt Assumed from Others	3,467,985
Less:	N/A	N/A
74A-0899,1	Debt Retirement Funds	
74A-1099,1	Sinking Fund Balances	0
74A-0610,1	Ontario assumed debt	0
74A-0620,1	School board assumed debt	0
Total	Debt Outstanding	96,431,676
10-0991,1	Total Revenues	484,508,861
Less:	N/A	N/A
10-0815,1	Ontario TCA Grants	521,713
10-0825,1	Canada TCA Grants	841,251
10-0830,1	Deferred revenue (Prov Gas)	710,045
10-0831,1	Deferred revenue (Fed Gas)	10,697,580
10-1098,1	Revenue from other municipalities TCA	590,620
10-1811,1	Gain/loss on sale of assets	277,886
10-1813,1	Deferred revenue (Cash-in-Lieu)	1,542,524

FIR Cell	Description	Amount
10-1814,1	Other deferred revenue	0
10-1830,1	Donations	395,177
10-1831,1	Donated TCA	9,560
10-1865,1	Other revenue from gov Business	0
10-1890,1	Direct developer charges	277,551
10-1891,1	Partner contributions	661,954
10-1905,1	Increase/decrease in gov business equity	6,703,552
12-1210,1	General assistance (Provincial)	9,167,113
60-1025,1	Development Charges (TCA)	17,754,370
76-1020,1	Dividends Paid gov business	2,000,000
Total	Net Operating Revenue	432,357,965
Ratio	2018 Year End	22%

6.2.2 Debt Service Cost to Net Operating Revenue

Calculated using the annual FIR as total debt charges/net operating revenue

FIR Cell	Description	Amount
74C-3099,1	Debt Charges – Principal	14,831,000
74C-3099,2	Debt Charges- Interest	3,324,381
Total	Total Debt Charges	18,155,381
Total	Net Operating Revenue (from 6.2.1)	432,357,965
Ratio	2018 Year End	4.2%

6.2.2 Debt Servicing to Discretionary Reserve Ratio

Calculated using the annual FIR as total debt charges/discretionary reserve and reserve fund balance

FIR Cell	Description	Amount
Total	Total Debt Charges (from 6.2.2)	18,155,381
60-2099,2	Balance year end, Discretionary Reserve Funds	174,955,612

FIR Cell	Description	Amount
60-2099,3	Balance year end, Discretionary Reserves	42,722,721
Total	Balance year end	217,678,333
Ratio	2018 Year End	12:1

6.2.2 Development Charge (DC) debt assessment

As each situation with regards to debt requirements for DC funded projects is unique there is no single calculation. The process will involve evaluating the overall level of debt compared to potential revenues under a variety of assumptions. The minimum requirement is that both the rate of growth and the total amount of growth must be reviewed to ensure that any change in these critical variable will not leave the City at financial risk.

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FACT SHEET ON MUNICIPAL DEBT

January 2018

This document discusses some common questions asked about Chatham-Kent's use of debt to finance various projects.

1. Why does Chatham-Kent need to borrow?

Borrowing is a way to finance capital projects and maintain major infrastructure over the longer term. Like most businesses, municipalities may borrow a portion of their capital requirements and pay it back over the life of the project being financed. Municipalities do not borrow for day-to-day operations.

2. Are there any alternatives to borrowing?

When faced with the decision to build a major capital structure, Council has to make a decision on how to finance the project. It could either raise taxes that year to pay for it, reduce spending on other capital projects to make room in the current capital budget, use money saved up in reserves, or borrow the funds and repay the debt using tax revenue over a period of time. Chatham-Kent has adopted a pay-as-you-go philosophy on most lifecycle projects. It considers debt financing when a new or one-time type of project comes along, and occasionally when major reconstruction is needed on large expensive assets.

3. Who does Chatham-Kent borrow from and can residents purchase municipal debentures as investments?

The majority of borrowing is through Infrastructure Ontario (a crown corporation of the Province of Ontario) as rates are more competitive than local lending institutions or private debenture issues, thus lowering costs to taxpayers of Chatham-Kent. There is no direct way for local residents to invest other than by purchasing Infrastructure Renewal Bonds from the Province.

4. How much debt does Chatham-Kent currently have?

The details below demonstrate Chatham-Kent's current $86.4 million of debt broken down into three major categories as of December 31, 2017

Category	December 31, 2017 Debt Outstanding
Debt paid by all Property taxpayers	$17.0 Million
Debt paid by Water and Sewer ratepayers	$48.8 Million
Debt paid by other sources of revenue (not paid from Property tax or Water and Sewer rates)	$20.6 Million
TOTAL	$86.4 Million

The $20.6 million of other source revenue debt is funded by industrial park land purchasers and by the Province on subsidized services such as a portion of Riverview Gardens Long Term Care facility and Social Housing projects.

5. How much principal does Chatham-Kent pay off annually?

In 2017 Chatham-Kent paid out $9.3 million of principal and $3.8 million of interest payments.

6. Will Chatham-Kent be borrowing in the near future?

There are no projects approved for borrowing by Council at this time.

7. Does Chatham-Kent have a significant amount of debt?

It may seem too many that $86 million of debt is a lot. To put it in perspective Chatham-Kent has annual taxation revenues of $145 million and tax funded debt payments of $2 million or approximately 1.4% of tax income, which is a very manageable level.

The Province monitors municipal debt levels and annually calculates Chatham-Kent's debt capacity and ability to repay the debt. Council is restricted by the Ministry of Finance to approve any debt that will result in total annual debt payments that will be more than 25% of Chatham-Kent's own source annual revenues. For

2018, the limit for Chatham-Kent would be $56 million in payments. To reach this limit at current interest rates, Chatham-Kent is allowed to borrow $580+ million of additional debt and repay it over 20 years. Of course that is not desirable, but merely illustrates that the current debt levels are not a concern to the Province.

Chatham-Kent has reduced its debt levels from a high of $162 million in 2010. If Council does not approve the use of debt for any new projects the debt level will fall to $38 million in 5 years.

8. Could Chatham-Kent raise taxes or use reserves to pay off the current debt early?

Chatham-Kent has taken advantage of several Provincial and Federal programs that provided subsidized interest rates. 36% of the outstanding debt is at interest rate below 3%. To obtain such historically low rates there are no options for early repayment offered by the issuing agencies.

9. How do other municipalities view and use debt?

Chatham-Kent is not unique in its use of debt. Infrastructure deficits exist in most, if not all municipalities and the Provincial and Federal governments as well. Most municipalities are also choosing to borrow a portion of their capital construction needs to finance long term assets and pay for them over the lifespan of the asset.

In conclusion, there is a need for the Municipality of Chatham-Kent to strategically use debt to invest in new assets that improve the community. It is only used on significant assets where annual lifecycle funding is not fully in place and significant tax increases would otherwise be required. As funding to shrink the infrastructure deficit increases, there will be less need for future debt issuances. If no new debt is issued, Chatham-Kent plans on paying off $48 million of debt over the next 5 years.

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CORPORATE POLICY AND PROCEDURE

POLICY	**Debt Management Policy**
CATEGORY	Finance
AUTHORITY	Council
RELATED POLICES	General Reserve and Reserve Fund Policy Investment Policy
APPROVED BY	Council
EFFECTIVE DATE	26 October 2009
REVIEW DATE	Within one year of adoption (on or before October 26, 2010)

1. POLICY STATEMENT

It is the policy of the City of Guelph

- to minimize both debt servicing costs and significant annual budget impacts
- that new debt be planned at a level which will optimize borrowing costs and not impair the financial position of the City, and
- to maintain or improve the City's credit rating.

2. PURPOSE OF POLICY

The purpose of this debt management policy is to

- Enhance the quality of decisions by promoting consistency;
- Establish the parameters regarding the purposes for which debt may be issued, the types and amounts of permissible debt, the timing of issuance and method of sale that may be used, and the procedures for managing outstanding debt;
- Integrate with other long-term planning, financial and management objectives of the City; and
- Assist with ensuring that the municipality maintains a sound financial position and that the worthiness of the City's credit rating is protected.

3. DEFINITIONS

Business Case – means an analysis that demonstrates the necessity for and viability of a new project. A business case will include a financial analysis and a financial plan that identifies and confirms sources of funding to provide for the financing of the capital and operating costs of a new project.

Capital Expenditures – means expenditures incurred to acquire, develop, renovate, or replace capital assets as defined by the Public Sector Accounting Board, section 3150.

Debt Service Cost – means debt repayments, including interest and principal (per FIR 74-3099).

Direct Debt – means the total debt burden of the City (per FIR 74-9910). It includes all debt issued by the City and consolidated entities less all debt assumed by others

Flexibility – is the ability of the City to issue new debt in response to emerging financing needs.

Net Revenue Fund Revenues – means total revenue fund revenue per line 9910 of FIR schedule 10 less grants received (10-0699 and 10-0899), less revenue from other municipalities (10-1099).

Infrastructure – large-scale public systems, services, and facilities of the City that are necessary for economic activity in the community, including water and wastewater systems, roads, and buildings / facilities.

Operating Revenue – means total revenue fund revenue per line 9910 of FIR schedule 10 less other revenue (10-1899), less grants received (10-0699 and 10-0899), less revenue from other municipalities (10-1099).

Sustainable – means meeting present needs without compromising the ability to meet future needs.

Statutory Annual Debt Repayment Limit – means the annual debt and financial obligation limit for municipalities as described under Ontario Regulation 403/02. The regulation provides a formula which limits annual debt service costs to an amount equal to 25% of operating revenue.

Tax-Supported Debt - means debt issued for capital expenditures related to tax-supported operations. This debt is repaid using net revenue fund revenues.

Tax-Supported Operations - means civic programs that are funded through net revenue fund revenues, such as roads, transit, and parks.

4. PURPOSES FOR WHICH DEBT MAY BE ISSUED

4.1 Tax-supported Debt

The City may borrow by debenture, mortgage or other acceptable debt instrument to finance the City portion of growth-related infrastructure, and emerging capital needs to support corporate priorities and approved strategic plans under the following conditions:

- the individual project value exceeds $500,000
- the estimated useful life of the asset is greater than ten years

- the project has been approved by Council as part of the annual capital budget and has been clearly identified as being funded by debt
- it is an appropriate means to achieve a fair allocation of costs between current and future beneficiaries or users
- the project is supported by a comprehensive business case including
- total cost of the project
- cash flow of the project including debt issuance
- operating costs after completion of the project
- benefits to the community
- funding cannot be accommodated within the tax-supported capital budget, and other internal sources (such as borrowing from reserve funds) and external sources (such as senior government grants and subsidies, private / public partnerships, or user-pay systems) have been thoroughly investigated

The City will not use long-term debt to fund current operations.

The City will not use long-term debt to fund the ongoing rehabilitation of existing infrastructure. This will be funded by reserves.

4.2 Reserve and Reserve Fund Debt

Debt servicing costs are not normally funded by reserves or reserve funds. Instead, debt shall be incurred and repaid through the operating fund with corresponding transfers to and from reserves. Any funding of debt costs shall be identified in the City's annual operating budgets. However, in accordance with the General Reserve and Reserve Fund Policy, there remains only one exception to this rule:

- Development Charge Reserve Funds – Under the Development Charges Act, debt may be included as a capital cost to leverage development charge revenue while waiting for DC collections to catch up to growth-related spending.

For the 5% Cash in Lieu of Parkland Reserve Fund and Industrial Land Reserve Fund, historically, debt has been permitted for the purchase of parkland, land or the servicing of City-owned land in anticipation of future Parkland Cash in Lieu or land sale revenues. This practice is no longer recommended in order to avoid the risk associated with uncertain revenue streams. Any new capital financing required for these purposes will be repaid through the operating fund.

5. LIMITATIONS ON INDEBTEDNESS

Debt limits will preserve borrowing capacity for future capital assets while maintaining maximum flexibility of current operating funds.

5.1 Statutory Limitations – Annual Repayment Limit (ARL)

The 2010 ARL is based on the City's 2008 Financial Information Return (FIR). The City is not allowed under Provincial regulation to issue debt which would result in the annual repayment limit being exceeded without OMB approval. In fiscal year 2008, principal and interest repayments totaled approximately 27% of the available legislated capacity.

5.2 Self Imposed Limitations

Notwithstanding the limits prescribed in the regulations, prudent financial management calls for more stringent criteria to limit debt. These criteria will assist in preserving borrowing capacity for future capital assets while maintaining maximum flexibility for current operating funds.

5.2.1 Direct Debt to Operating Revenue
This measure identifies the percentage of annual operating revenues that would be required to retire the City's net debt. It is also the prime measure used by Standard and Poor's when assessing the debt burden of the municipality. A target rate of **less than 55%** should be maintained.

5.2.2 Debt Service Cost to Net Revenue Fund Revenue
This ratio is a measure of the principal and interest payable annually as a proportion of revenue fund revenues. It should not exceed a target of **10%**.

5.2.3 Development Charge Debt Servicing Ratio
This ratio is a measure of the debt service cost of the debt issued to support the DC reserve funds as a percentage of the average revenue forecast as identified in the DC background study. It should not exceed a target of **20%** for hard services (Roads, Storm water, Water works, Waste water) and **10%** for all other Development Charge reserve funds. Note: additional capacity has been provided for the hard DC services in recognition of the substantial front end financing required.

5.2.4 Direct Debt to Reserve Ratio
This ratio compares direct debt to the total of all reserves and reserve funds.
A generally accepted target ratio for municipalities is considered to be **1:1** and this level should be achieved within the next five years and maintained thereafter.

6. TYPES OF DEBT

6.1 Short-term Debt (under one year)

The City may use either of the following sources to fund short-term operational needs:
- Reserve and reserve fund loans
- Bank line of credit

6.2 Medium-term Debt (one to four years)

The City may use any of the following sources to fund medium-term needs:

- Reserve and reserve fund loans
- Operating and capital leases
- Term loans
- Promissory notes

6.3 Long-term Debt (five years or greater)

The City may use any of the following sources to fund long-term needs:

- Municipal serial or amortized debentures
- Term loans / mortgages with any Canadian bank
- Capital leases
- Reserve and reserve fund loans

6.4 Internal Borrowing from City Reserves and Reserve Funds

When an analysis of the reserve or reserve fund has determined that excess funds are available and that the use of these funds will not adversely affect the intended purpose of the reserve or reserve fund, the City's reserve funds may be used as a source of financing for short to long term purposes. The reserves will be repaid with interest at a rate based on the actual annual average balance of the reserve fund and the Royal Bank Prime rate minus 1.75% (which is the interest rate received on City accounts) as specified in the City's reserve policy.

Each such loan is to be authorized by a specific by-law passed by Council and set out the amount, interest, term of the loan, and the specific reserve or reserve fund from which the loan is made. Borrowing in this manner offers several advantages over traditional debenture financing including the following:

- Increased flexibility in setting loan terms,
- Lower interest cost, and
- Avoidance of legal and fiscal agent fees.

7. STRUCTURAL FEATURES

7.1 Debt Denomination

The City shall issue debt denominated in Canadian dollars only.

7.2 Fixed Interest

The City shall issue general obligation debt with a fixed rate of interest. Interest rate swap agreements may be used to exchange floating-rate interest payments for fixed-rate interest payments.

7.3 Repayment Terms

The repayment term will be dependent on the useful life of the asset being acquired by the City, but should not exceed ten years except for major capital construction of public facilities. In no case shall the amortization period exceed 25 years.

7.4 Debt Structure

7.4.1 Debt shall be structured for the shortest period consistent with a fair allocation of costs to current and future users.

7.4.2 Debt shall be structured to achieve the lowest possible net cost to the City given market conditions, the type of debt being issued, and the nature and type of the repayment source.

7.5 Repayment

7.5.1 Unless otherwise justified and deemed necessary by the City's Fiscal Agent, the

repayment schedule should be structured on a level or declining payments basis.

7.5.2 Early repayment of debt may be considered if it is financially beneficial to do so.

8. CREDIT OBJECTIVES

8.1 Credit Rating

The City will continually strive to maintain or improve its current AA stable credit rating by adhering to sound financial management practices. This practice will ensure the long-term financial health of the City so that its borrowing costs are minimized and its access to credit is preserved. Standard and Poor's (S&P) is the City's debt rating agency. City staff carry out a review with S&P officials to provide updates on information affecting the City's financial position.

9. USE OF FINANCIAL ADVISORS

9.1 Fiscal Agent

The City will engage the services of a Fiscal Agent to develop the debt issuance strategy, determine the interest rate and method of calculating the interest rate, and to market bonds to investors.

9.2 Syndicate of Investment Dealers

The City will use the services of the syndicate of investment dealers principally managed by National Bank Financial (NBF) because of their substantial presence in the Canadian municipal market.

9.3 Formal Review of Financial Advisors

The Director of Finance will undertake a formal review of the Fiscal Agent or Syndicate as warranted. The formal review process may include establishing a set of criteria (including fee structures), presence in the capital markets, placement of bonds in volume, dollar terms, etc., and any other criteria that may be deemed to provide value to the City through the review process.

9.4 Notwithstanding Section 8.3, the City retains the ability to enter into a private placement for the sale of debentures or any other permitted debt financing product without the services of a Fiscal Agent or Syndicate should it be determined that this is in the City's best interests both from a cost and an administrative viewpoint.

9.5 External Legal Counsel

For all debt issues, the City will retain external legal counsel who will assist with the drafting and reviewing of the debt issue bylaw and related schedules.

10. COUNCIL AUTHORIZATION FOR DEBENTURE ISSUE

10.1 Approval of Funding for Capital Projects

The approval to fund an eligible capital project by debenture will generally be sought through the annual capital budget process. The funding of emerging strategic priorities outside of the traditional budget process shall be approved by specific by-law.

10.2 Debenture Issue

Each debenture issue shall be approved by specific by-law of Council including the term, rates of interest, debt servicing obligation, and general terms of issue.

11. ADMINISTRATION

11.1 The borrowing to finance capital projects will normally occur once the projects are essentially completed.

11.2 When feasible, debt issuances will be pooled to minimize issuance costs.

12. POLICY REVIEW

This policy will be reviewed within one year of adoption.