

# Council Memo



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Date February 24, 2020  
To City Council  
From Greg Clark, Manager of Financial Strategy and Long-term Planning  
Service Area Corporate Services  
Department Finance  
**Subject Debt Management Policy**

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During the discussion of staff report CS-20-2020 Debt Management Policy Update on February 3, 2020, items were identified in the accompanying policy that required staff to make minor changes.

The changes which have been made do not materially impact the policy, however they correct or clarify items that were identified by Council, as follows:

- Debt Servicing Cost to Discretionary Reserve ratio was incorrectly identified as a target of 14:1, the proper ratio is 1:14 is now shown in section 6.2.3.
- The use of internal borrowing is intended for short to medium-term borrowing as required between external debenture issuance; the language in section 8.2 has been adjusted accordingly.
- The term adequate was not clearly defined, and section 10.1 now more clearly articulates that the City's goal is maintain or potentially improve our current AA+ rating by Standard and Poor's.

The policy as attached will be used to manage the City's debt once approved by Council.

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# Corporate Policy and Procedure

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Policy	<b>Debt Management Policy</b>
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

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## 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 14:14 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 through 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 longmedium-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 (minimum of AA+ as rated by Standard and Poor's) to enable efficient access to debt and favourable terms of repayment.

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
10-1814,1	Other deferred revenue	0
10-1830,1	Donations	395,177
10-1831,1	Donated TCA	9,560

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

### **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.