For Information Only

Information Session on Debt Financing

Presented To:	Finance and Administration Committee
Presented:	Tuesday, Mar 28, 2017
Report Date	Wednesday, Mar 15, 2017
Type:	Presentations

Resolution

For Information Only

Finance Implications

There are no financial implications associated with this report.

Signed By

Division Review
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Digitally Signed Mar 15, 17

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Background

During the 2017 budget process, Councillors raised the issue of using debt as an instrument to move projects forward. Subsequent to the approval of the 2017 budget a number of Councillors have requested an information session regarding the use of debt for development. This report on debt financing will identify the City's debt capacity, provide a comparison of the City's debt level to other municipalities, identify committed and uncommitted reserve funds, provide an explanation of internal vs. external debt, identify the value of implementing a capital levy, and reflect the value of debt financing to enable the City to fund its share of Phase 2 of the Federal Infrastructure Stimulus Program. At the March 7, 2017 Council meeting, an additional request was made; that being proposing alternative sources of funding the debt repayment while minimizing or eliminating the need for a tax increase. One such avenue deals with retired debt; where the debt repayments would be used for new debt issues. Currently, in accordance with policy, debt payments from retired debt are converted to a contribution to capital.

The Debt for Development Session of the March 28, 2017 Finance and Administration Meeting will explore options available to the City for securing and managing debt.

Debt Management Policy

In October of 2013, City Council approved a debt management policy, which set out the parameters for securing debt, managing the outstanding debt, providing guidance regarding the timing of debt, type of instrument to be used, and the purpose for the use of debt.

The City's debt financing strategy should be coordinated with the City's long term plans. The policy also states that the debt should be affordable and sustainable and should be structured in an equitable manner to have those that benefit from the asset pay for the debt. The policy also sets out the principles of debt financing in accordance with the City's Long Term Financial Plan. The principles state that debt financing should only be considered for:

- New, non-reoccurring infrastructure requirements
- Programs and facilities which are self supporting
- Projects where the cost of deferring expenditures exceeds debt servicing costs
- Securing debt for terms no longer than the anticipated life of the funded asset

The policy addresses the following debt categories:

1) Tax Supported Debt - The debt repayment sources would be on the tax levy.

2) Self Supporting Debt - The debt repayment source would be outside the tax levy, such as user fees or development charges. Such projects would include, but not limited to, water/wastewater projects, parking lot improvements, growth related projects where other revenues would provide for debt servicing costs.

A copy of the Debt Management Policy is attached as Appendix A.

Debt Capacity

Each year the Ministry of Municipal Affairs and Housing provides the City with a document for the determination of its annual debt repayment limit. For 2016, based on the City's 2014 Financial Information Returns (FIR), which reflects the City's net revenues at $388 million, the Ministry uses 25% of net revenues for an annual repayment limit ceiling of $97 million. The Debt Management Policy restricts the City's maximum annual debt repayment at 5% of net revenues. This policy may be revisited to modify this ceiling if more debt is desired. The following chart reflects the amount of debt that can be secured at the current policy level, 10% of net revenue, and 25% of net revenue (Ministry of Municipal Affairs and Housing limit).

($ millions)		Current Annual Debt Repayment*	Available Debt Repayment	20 Year Debt Secured @ 3.4%	30 Year Debt Secured @ 3.7%
2014 Net Revenues	$388				
Ministry of Municipal Affairs 25%	$97	$9	$88	$1,262	$1,579
Current Policy 5%	$19	$9	$10	$143	$179
Change Policy to 10%	$39	$9	$30	$430	$538

*Current annual debt repayment includes external debt and long term obligations to community partners as reflected in Appendix B.

This chart reflects the amount of debt that can be secured/funded over a 20 and 30 year period.

As reflected under the current policy the City could secure an additional $143 million in debt for capital projects for a 20 year term.

How Does Sudbury Compare to Others

The BMA study that the City participates in on an annual basis compares 105 municipalities across Ontario on a number of factors. There are various measures that deal with debt and the following chart reflects how Greater Sudbury compares to others in the 2016 survey.

	Tax Debt Interest as % of Net Revenues	Tax Debt Charges as % of Net Revenues	Debt to Reserve Ratio
Greater Sudbury	0.4%	2.0%	0.5
Median	1.2%	4.0%	0.7
Average	1.4%	4.4%	1.1

These figures are based on the 2015 Financial Information Returns (FIR). In all cases, the City is in a favourable position.

Using Committed Reserve Funds for Capital Projects

At a previous Finance and Administration Committee meeting, a request was made to evaluate the use of committed reserve funds to fund capital projects as these committed funds may not be required for their intended purposes until much later. There are approximately $96 million of committed reserves. The largest amount is the allocation of $16 million for Maley Drive.

As well, there are also committed reserve funds that are required for the City's obligations. The following table identifies some of the larger committed reserve funds. Some of the balances noted below include commitments from the 2017 Capital Budget.

Committed Reserve Fund	Description	Balance Estimated @ December 31, 2016
Human Resources Management Reserve Fund	Used for claims fluctuation, succession planning, other potential liabilities and employee rewards and recognition programs	$5.0 Million

WSIB Reserve Fund	City is no longer able to secure insurance for catastrophic events, therefore must self insure; also included is the new presumptive legislation creating more liability in this area	$3.9 Million
Capital Financing Reserve Fund – General	Used for a number of one time projects, which include TDS elevator replacement, solar panel project, and funds for market development	$4.8 Million
Capital Financing Reserve Fund - Water	Contains funds committed from previous capital budgets; as well, it also includes the water stabilization allocation of 10% of revenues as per the Reserve Funds By-law	$11.6 Million
Capital Financing Reserve Fund – Wastewater	Contains funds committed from previous capital budgets as well it also includes the wastewater stabilization allocation of 10% of revenues as per the Reserve Funds By-law	$9.0 Million
Capital Financing Reserve Fund – Roads	Contains funds committed from previous capital budgets and funds which are currently deferred for a later date including Maley Drive and several bridge rehabilitations/replacements	$28.6 Million

In addition to the committed reserve funds, there are a number of uncommitted reserves and reserve funds with significant balances that are required to fulfil obligations of the City. The following table provides a list of some of these reserves with larger balances.

Reserves & Reserve Funds	**Description**	**Balance Estimated @ December 31, 2016**
Tax Rate Stabilization	This reserve provides for year-to-year variances in the operating budget	$3.3 Million
WSIB	The funds are used to pay for invoices from WSIB and to pay rehabilitation expenses	$3.1 Million
Industrial Reserve Fund	The funds are used for the expansion or creation of industrial parks	$2.3 Million
Roads – Winter Control Reserve Fund	The funds may be used to offset winter control over-expenditures	$1.0 Million
Capital Financing Reserve Fund – I.T.	The funds are used for Information Technology projects	$2.6 Million
Capital Financing Reserve Fund – EMS	The funds are used for ambulance capital projects including all vehicles, equipment, and stations	$1.2 Million
Capital Financing Reserve Funds – Roads	Funds to be used for capital roads projects	$3.7 Million
Capital Financing Reserve Funds – Water	Funds to be used for water projects including any projects necessitated by the Ministry of the Environment	$4.9 Million
Capital Financing Reserve Funds – Wastewater	Funds to be used for wastewater projects including any projects necessitated by the Ministry of the Environment	$7.7 Million

The Police Services Reserve Funds have not been identified in the above charts as the reserve funds are under the control of the Police Services Board.

As outlined in the BMA study, reserves and reserve funds are a critical component of a municipality's long-term financing plan. The purpose for maintaining reserves, as outlined in the report, is to:

- Provide stability of tax rates in the face of variable and uncontrollable factors (consumption, interest rates, unemployment rates, changes in subsidies)
- Provide financing for one-time or short term requirements without permanently impacting tax and utility rates
- Make provisions for replacements/acquisitions of assets/infrastructure that are currently being consumed and depreciated
- Avoid spikes in funding requirements of the capital budget by reducing their reliance on long-term debt borrowings
- Provide a source of internal financing
- Ensure adequate cash flows
- Provide flexibility to manage debt levels and protect the municipality's financial position
- Provide for future liabilities incurred in the current year but paid for in the future

Internal vs. External

The City's rate of return on investments for 2016 was 1.83% when considering interest earned only. With the additional returns realized from the capital gains, the rate of return is 2.0%. During January and February, Infrastructure Ontario's lending rates (used as a benchmark) for 20 year borrowing has ranged from 3.3% to 3.5%. If reserve funds were used rather than external borrowing, the opportunity cost would be the 2.0% lost rate of return from the investment portfolio on the funds used. As a result, there would be a slightly positive impact in the short term, however, the City may lose the ability to borrow at low rates that are currently being offered. If the City considers external debt financing, the City will be locked into a considerably low interest rate for 20 years in a potentially rising interest rate environment. In this case, the City will also benefit with higher future rates of return on our investment portfolio, ultimately benefitting the reserve funds.

For major capital projects, the debt should be identified for a specific project with a specific time line matching the anticipated life of the asset. Therefore, it would not be considered prudent to use reserve funds for internal long term debt financing. Internal debt should be utilized for smaller capital projects and a projected shorter repayment period. For larger projects, external debt financing should be pursued and the debt repayment period should match the life of the asset to ensure that those individuals consuming or benefiting from the asset pay for it.

Currently the City can only secure debt but not issue debt, as the City does not have a credit rating. This rating is necessary for the municipality to issue debt. The benefit of obtaining a credit rating will be addressed by our guest speaker during the March 28, 2017 session.

The cost of acquiring and maintaining a credit rating would have to be taken into account when analyzing the cost of borrowing to identify if a rating would be beneficial.

Implementation of a Capital Levy to Fund Capital Projects

In an attempt to address the City's infrastructure requirement, Council may also consider implementing a capital levy. This could be used to enhance the annual capital program or to secure debt.

A capital levy of 1% ($2.5 million) could leverage $36 million of debt to be used for capital programs for a 20 year loan and $45 million for a 30 year term. The City's Long Term Financial Plan identified the use of a capital levy.

Debt Retirement

In accordance with the Capital Budget Policy, as debt is retired, the debt repayment that was used to service the loan is converted to a contribution to capital to be used for other capital projects. Alternatively, council may wish to use these funds for debt servicing for additional upcoming capital initiatives.

Appendix B reflects the projects that are being serviced with external debt as well as long term obligations to community partners. This chart reflects the period of funding, the total debt acquired, the annual debt repayment and when the funds are available for future projects.

Federal Infrastructure Stimulus

Phase one of the Federal Infrastructure Stimulus, which totalled $11.9 billion of federal funding, supported water/wastewater projects and public transportation. It is expected that Phase 2 of the infrastructure funding will be announced as part of the 2017 Federal Budget, which will be brought down on March 22, 2017.

In the previous phase of funding, Minister Sohi stated that the government wants “shovel ready and shovel worthy” projects and he stressed the importance of investing in maintaining the assets to extend the life cycle of these assets.

As a result the City should have projects that are shovel ready and shovel worthy and a funding plan to secure our share of the funding requirements to take advantage of this stimulus program.

SUMMARY

As a result of the current low interest rate environment in Canada, it would be prudent to fund large capital projects with external debt. The City should be prepared to identify shovel ready projects to the Federal Government and consider appropriate funding sources.

Appendix A

THE CITY OF GREATER SUDBURY
POLICIES AND PROCEDURES

DEPARTMENTS:	All Departments		
SECTION:	All Sections	**TITLE:**	Debt Management Policy
APPROVED BY:	City Council	**DATE**:	October 8, 2013

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Purpose

The purpose of the Debt Management Policy is to set out the parameters for securing debt, managing outstanding debt and provides guidance regarding the timing of debt, type of debt instrument and the purpose for which the debt will be used.

Policy Statement

- Debt is an ongoing component of the City's capital financing structure and should be coordinated with the City's long-term plans and strategies
- Debt must be affordable and sustainable
- Debt should be structured in an equitable manner to those who pay should benefit from the asset
- Issuing or securing new debt should be only approved by Council
- Debt must be managed, monitored and reported upon

1.0 Principles of Debt Financing

The City's Capital Policy By-law 2012-119 states:

In accordance with the Long Term Financial Plan (L TFP), more specifically, Principle #7 "use debt financing where appropriate", any internal or external debt financing must be approved by Council, and should only be considered for:

- new, non-recurring infrastructure requirements
- programs and facilities which are self-supporting, and
- projects where the cost of deferring expenditures exceeds debt servicing costs

The LTFP also stated that Council should:

- Consider undertaking a short-term, managed program of debt financing to address the City's current infrastructure deficiency and to reduce further deterioration of the City's infrastructure
- Issue or secure debt for terms no longer than the anticipated life of the funded assets

Reductions in External Debt Repayments

The LTFP also recommends: "As debt charges decline due to retirement of debt, apply savings to accelerate achievement of full life cycle costing for City infrastructure."
When preparing the annual budget, any decrease in annual debt repayments shall be offset by a corresponding increase in the contribution to the respective Capital Envelope. This allows the envelopes to increase while having no impact on the operating budget.

2.0 Debt Approval

2.1 The Capital Policy By-law #2012-119 also provides guidance regarding debt approval.

Finance Approval for Debt Financing

If a capital project is identified that meets the above noted criteria for debt financing, an application should be made by the SMT member to the Chief Financial Officer.

The Financial Planning and Policy Section will determine if it is in the City's best interest to finance the project internally or externally.

Council approval is required for either internal or external debt financing.

Internal Debt Financing

From time to time, a capital project may require internal debt financing, with repayments to come from future capital envelopes or other sources over time. If the term of the repayment exceeds two years, then interest will be charged.

Any internal financing recommended to Council will be in accordance with the City's Investment Policy, which states that interest will be charged at one percent above the average investment rate locked in at the time the internal financing is approved. Finance will provide interest rates and amortization schedules for each project with internal debt financing.

2.2 A multi year debt service funding strategies consistent with the capital planning and budget cycle will be developed. Capital projects requiring debt financing should be identified during the budget process.

3.0 Debt Categories

To facilitate debt planning, management and reporting, debt is categorized into two groups based on the funding source for the debt servicing:

1. Tax Supported Debt – the debt repayment source would be the tax levy

2. Self Supporting Debt – the debt repayment source would be outside the tax levy – such as user fees or development charges. Such projects would include but not limited to water/wastewater projects, parking lot improvements, growth related projects, arena projects where other revenues would provide for all operating costs and debt servicing costs

4.0 Debt Limits

The municipal debt limits based on debt servicing costs are:

5% of Net Revenues or Own Purpose Revenues (as identified in the Ministry's Annual Repayment Limits). This refers to the total revenue the municipality receives and it is discounted for items such as the Ontario and Canada grants, deferred revenue earned and gain/loss on sale of land and capital assets.

5.0 Debt Instruments

The following are guidelines for the City:

- Issue an RFP to secure the best interest rates and terms available

- Obtain a credit rating from one of the rating services if it would assist in reducing the interest rate significantly, and the benefits outweigh the costs

- Make application and secure debt from Infrastructure Ontario if rates are lower than through the RFP process, and the terms are more favourable

- Use of debentures should be considered if bank rates or Infrastructure Ontario rates are not appealing

- Acquisition of financing through a Private Public Partnership (P3) must be approved by Council

- Before entering into a Capital Lease, it must be in accordance with Bylaw 2003-213

- Make use of Municipal Swaps when available to reduce interest costs

6.0 Debt Amortization Term

Debt term shall not exceed the probable life of the asset. If the debt term is less than the life of the asset and affordable, this would be recommended with the view of minimizing long term financing costs. (Municipal Act cannot exceed forty years).

Minimizing costs will be balanced against being fair and equitable to taxpayers that pay and benefit from the underlying assets over time.

7.0 Reporting and Monitoring

Staff will monitor this regularly and at a minimum report annually against the limits and guidelines identified in Section 4.0.

Staff will also periodically review benchmark data from other municipalities.

Appendix B
Capital Projects Funded with External Debt
and City Long-Term Obligations to Community Partners

				Funds Available as Debt Paid Off							
Project Name	**Term** (Start Date - End Date)	**Total Principal Amount Borrowed/ Committed**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
Northern Ontario School of Architecture	2009-2019	10,000,000	1,000,000		(500,000)	(1,000,000)	(1,000,000)	(1,000,000)	(1,000,000)	(1,000,000)	(1,000,000)
Health Sciences North	2001-2023	26,700,000	1,000,000						(300,000)	(1,000,000)	(1,000,000)
AMRIC	2014-2018	500,000	100,000		(100,000)	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)
199 Larch St*	2003-2023	17,261,363	1,455,630							(1,455,630)	(1,455,630)
Pioneer Manor**	2004-2024	10,000,000	817,758								
1160 Lorne St	2015-2035	14,000,000	940,156								
Biosolids Plant	2015-2035	46,781,000	3,456,200								
Falconbridge wells	2009-2025	2,000,000	181,000								
Onaping wells	2010-2029	2,175,000	172,500								
		129,417,362.69	9,123,244	-	(600,000)	(1,100,000)	(1,100,000)	(1,100,000)	(1,400,000)	(3,555,630)	(3,555,630)

Notes:
* These funds will be required for capital needs of the building.
** The Pioneer Manor debt is funded through a construction per diem from the Ministry of Health and Long Term Care . When the debt is fully paid, the construction per diem will cease.