

Staff Report

Report To: Corporate Services Committee
Report From: Kate Allan, Director of Corporate Services
Meeting Date: June 24, 2021
Report Code: CR-21-054
Subject: FS23 Tax Funded Debt Management Policy

Recommendations:

THAT in consideration of Staff Report CR-21-054 respecting FS23 Tax Funded Debt Management Policy, the Corporate Services Committee recommends that City Council direct staff to bring forward a by-law to adopt the policy as presented.

Highlights:

- Debt is an essential part of the City's long term financial planning strategy.
- A debt management policy strengthens a municipality's credit score.
- As of writing this report the tax levy fund \$1,910,000 in total debt charges including \$366,510 in interest.

Strategic Plan Alignment:

Strategic Priority: Clear Direction - KR2 - Align total municipal levy to Council's directed threshold each year while maintaining capital increase of 1 per cent annually

Background:

Debt financing is a key source of funding that helps to fulfill the City's multi-year capital plan. A debt management policy is proposed to help guide the

effective management of debt and plan for future use of debt while ensuring the delivery of infrastructure and services in a sustainable manner.

The Municipal Act, 2001 provides several legislative safeguards to ensure that fundamental activities and responsibilities are discharged by the municipal government and its officials in the management of any debt issued by (or on behalf of) the City. The development of the Debt management policy has taken these into account, some of which include:

- 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.
- Total annual financing charges cannot exceed the Annual repayment Limit unless approved by the OMB.
- Before leasing an analysis will be prepared that assesses the costs as well as the financial and other risks associated with lease vs other methods of financing.
- Prior to passing a debenture by-law Council will have considered all financial risks related to the proposed construction financing

Analysis:

Historically without a formal debt policy, City budgets have informally followed a policy of maintaining total debt at a total fixed cost. As old debt matures, the threshold for new debt increases by the same amount. The policy presented with this report allows for an increase in the threshold of total debt as a percentage of the budget such that it will remain within a certain percentage rather than at a fixed value. This allows for the total annual capital investment to grow along with our budget. That being said, there is no requirement to maintain debt at that level, only the room for future debt should interest rates and the nature of investment be favourable for long term financing.

The foundation of the debt policy relies on the Key Result of maintaining an annual levy increase dedicated to capital of 1 per cent. As defined in the policy, “total capital charges” include the annual levy contribution to the capital reserve, storm water reserve fund, equipment reserve funds and facility reserve funds as well as the annual tax funded debenture payments. The definitions, funding sources, and purposes of reserve funds are governed by the reserve and reserve fund policy. The total capital charges in 2021 are \$5,717,986 broken down as follows:

Capital reserve fund contribution	\$2,475,500
Equipment reserve contributions	\$907,500
Facility reserve contributions	\$145,500
Storm Water Reserve Contribution	\$125,000
Matured Debt (held in capital res)	\$156,079
Net Debt Charges	\$1,908,907

Each year the aggregate total increase to these accounts is equal to a 1 per cent increase in the tax levy. Based on the 2021 levy of \$31,660,000 this will mean an additional \$316,600 in 2022. Note that this increase is not entirely added to the capital reserve. If new debt over and above the matured amount held in the capital reserve is issued, it will reduce the amount to be added to the other capital categories. If the transfer to equipment reserves is increased, it comes out of the dedicated 1 per cent and so on.

Based on our estimated 2022 reserve funding requirements and known matured debt, the \$316,600 in new capital funding will result in an increase in contributions to the capital reserve of \$160,401 due to increasing reserve contributions utilizing the remaining balance. The capital reserve is essentially the fund we draw from to “tax fund” current year capital projects.

The new policy ensures that total debt charges will never exceed 10 per cent of the tax levy. Current debt charges are approximately 6.3 per cent and the goal is to reduce them to 5 per cent by 2033. Because debt charges are part of the total capital charges, when debt is below the maximum threshold it leaves more to be allocated to capital reserves and current year capital spending. In the event that debt charges approached the threshold of 10 per cent, the funds available for current year capital would be decreased to offset it.

Staff maintain a debt planning workbook. With the dedicated 1 per cent to capital, a goal debt charge threshold of 5 per cent and stable increments to dedicated reserve funds the total capital charges ten years from now will be \$9,898,843 broken down as follows:

Capital reserve fund contribution	\$4,767,482
Equipment reserve contributions	\$1,753,500
Facility reserve contributions	\$395,000
Storm Water Reserve Contribution	\$225,000
Matured Debt (held in capital res)	\$994,595
Net Debt Charges	\$1,793,266

Having a policy and accurate estimates for future fund availability allows for effective financial and asset management planning strategies.

In this model, the future projects to be debenture financed are:

1. 10th St Bridge
2. Alpha Street Reconstruction – all Phases

In addition, there is room to increase the debt burden by \$1,250,000 should an additional need be identified for which debenture financing is reasonable.

Further to the statutory limits noted previously, other limits for debt financing as follows:

- Capital debentures must be included as funding sources in the multiyear capital budgets and explicitly communicated such that they are approved by Council at budget.
- The City will not issue a debenture for a project that has a total cost of less than \$1,000,000.
- The City will not issue debenture for rolling stock (fleet) as these purchases are to be funded by reserves.
- As noted above, total debt charges will not exceed 10 per cent of the prior year's municipal levy.
- In order to reduce the total cost of interest associated with any specific project, debenture funding will not exceed 70 per cent of total capital project costs. This ensures that debt financing is utilized after all other sources of revenue have been considered.
- Amortization periods are set at 10 years except when the useful life of the asset exceeds 50 years in which case other amortization periods up to 25 years may be considered. This matches the payment to the estimated useful life of the asset it relates to and ensures we are not paying debt on assets that are no longer in service.

- Matured debt payments are credited back to the capital reserve. This ensures that year over year, the total capital charges never decline as a result of maturing debt and we continue to increase the aggregate amount by the dedicated 1 per cent as defined in the City's strategic plan.
- An annual report on outstanding debt and debt costs will be provided to Council.

Financial Implications:

In combination with other City policies, the tax funded debt policy ensures that an annual dedicated increase of 1 per cent of the prior year municipal levy will continue to increase our total investment in capital as we work to close the infrastructure gap over the long term.

Communication Strategy:

City policies are available on the SHARE network.

Consultation:

Other Municipal debt policies including the City of Guelph, Town of Parry Sound, and the Region of Peel

Royal Bank of Canada, the City's financial institution

Infrastructure Ontario

Attachments:

FS23 Tax Funded Debt Management Policy

Recommended by:

Kate Allan, Director of Corporate Services

Submission approved by:

Tim Simmonds, City Manager

For more information on this report, please contact Kate Allan, Director of Corporate Services at kallan@owensound.ca or 519-376-4440 ext 1238.