Presented To:	Finance and Administration Committee
Presented:	Wednesday, Mar 30, 2016
Report Date	Monday, Mar 14, 2016
Type:	Presentations

For Information Only

Debt Financing

Resolution

For Information Only

Background

Find attached the Debt Financing Report previously distributed to the Finance and Administration Committee during the 2016 budget deliberations.

Signed By

Report Prepared By
Ed Stankiewicz
Acting Chief Financial Officer/City Treasurer
Digitally Signed Mar 14, 16

Recommended by the C.A.O.
Kevin Fowke
Acting Chief Administrative Officer
Digitally Signed Mar 14, 16

Request for Recommendation

Finance and Administration Committee

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Type of Decision									
Meeting Date	February 2, 2016				Report Date	January 28, 2016			
Decision Requested		Yes	X	No	Priority	X	High		Low
	Direction Only				Type of Meeting	X	Open		Closed

Report Title
Debt Financing

Budget Impact/Policy Implication	
X	This report has been reviewed by the Finance Division and the funding source has been identified.
X	**Background Attached**

Recommendation	
For Information Only	
	Recommendation Continued

Recommended by the Department
Ed Stankiewicz Acting Chief Financial Officer/Treasurer

Recommended by the C.A.O.
Kevin Fowke Acting Chief Administrative Officer

BACKGROUND

At the January 19, 2016 Finance and Administration Committee meeting a parking lot request was made to provide a report on debt financing identifying the City's debt capacity, the City's ability to access our current investment portfolio for internally debt financing, and provide comparison of the City's debt levels to other municipalities.

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 debt categories, that being:

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 (such as arenas) where other revenues would provide for debt servicing costs.

A copy of the Debt Management Policy is attached.

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 2015, based on the City's 2013 Financial Information Returns (FIR), which reflects the City's net revenues at $379 million, the Ministry uses 25% of net revenues for an annual repayment limit ceiling of $95 million. The Debt Management Policy restricts the City's maximum annual debt repayment at 5% of net revenues. Council has indicated that this policy may be revisited to modify this ceiling if more debt is required. 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	Debt Secured @ 3.2%	Debt Secured @ 3.5%
2013 Net Revenues	$379				
Ministry of Municipal Affairs 25%	$95	$9	$86	$1,256	$1,222
Current Policy 5%	$19	$9	$10	$146	$142
Change Policy to 10%	$38	$9	$29	$424	$412

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

As reflected under the current policy the City could secure an additional $142 million in debt for capital projects.

How Does Sudbury Compare to Others

The BMA study that the City participates in on an annual basis compares 104 municipalities across Ontario on a number of factors. There are a number of measures that deal with debt and the following chart reflects how Greater Sudbury compares to others in the 2015 survey.

	Tax Debt Interest as % of Net Revenues	Tax Debt Charges as % of Net Revenues	Debt to Reserve Ratio
Greater Sudbury	0.3%	1.5%	0.2
Median	1.3%	3.2%	0.7
Average	1.4%	4.2%	1.1

These figures are based on the 2014 Financial Information Returns (FIR). In all cases, the City is in a favourable position.

Using Committed Reserve Funds for Capital Projects

At the Finance and Administration Committee meeting of January 19, 2016, 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. As reflected in another report on this agenda, there are approximately $21 million of committed reserves, which could be used to fund projects. The largest amount is the allocation of $12.2 million for Maley Drive. The second largest committed amount is for the Whitson-Paquette Drain at $4.1 million. These amounts include allocations identified in the 2015 and previous budgets.

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.

Committed Reserve Fund	Description	Balance Forecast @ December 31, 2015
Human Resources Management Reserve Fund	Used for claims fluctuation, succession planning, other potential liabilities and employee rewards and recognition programs	$6.1 Million
WSIB Reserve Fund	City is no longer able to secure insurance for catastrophic events, therefore must self insure	$3.6 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	$6.0 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	$8.6 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	$5.6 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	$22.3 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 Forecast @ December 31, 2015**
Tax Rate Stabilization	This reserve provides for year-to-year variances in the operating budget	$2.6 Million
WSIB	The funds are used to pay for invoices from WSIB and to pay rehabilitation expenses	$4.1 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	$3.1 Million
Capital Financing Reserve Fund – I.T.	The funds are used for Information Technology projects	$3.6 Million
Capital Financing Reserve Fund – EMS	The funds are used for ambulance capital projects including all vehicles, equipment, and stations	$2.3 Million
Capital Financing Reserve Funds – Roads	Funds to be used for capital roads projects	$11.2 Million
Capital Financing Reserve Funds – Water	Funds to be used for water projects including any projects necessitated by the Ministry of the Environment	$3.4 Million
Capital Financing Reserve Funds – Wastewater	Funds to be used for wastewater projects including any projects necessitated by the Ministry of the Environment	$9.5 Million

Some of the balances noted above are committed as part of the 2016 Capital Budget.

None of the Police Services Reserve Funds have 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 2015 was 1.97% when considering interest earned only. With the additional returns realized from the capital gains, the rate of return is 3.1%. For the last two months Infrastructure Ontario's lending rates (used as a benchmark) for 20 year borrowing has ranged from 3.1% to 3.3%. If reserve funds were used rather than external borrowing, the opportunity cost would be the 3.1% lost rate of return from the investment portfolio on the funds used for additional capital. As a result, monetarily there would be very little impact in the short term, however, the City would 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.

Implementation of a Capital Levy to Fund Capital Projects

In an attempt to close the infrastructure gap 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% ($2.3 million) could leverage $33 million of debt to be used for capital programs. The City's Long Term Financial Plan identified the use of a capital levy.

Federal Infrastructure Stimulus

Minister Sohi recently announced the government's approach to the Infrastructure Stimulus Program. He reiterated the government's overall infrastructure commitment of $60 billion. He had stated the first approach is getting $10 billion working for the economy now, noting that he trusts municipal governments to set priorities. The government wants "shovel ready and shovel worthy" projects and the Minister spoke to the importance of investing in maintenance deferral to extend the life cycle of assets, using examples such as water and wastewater, housing, and upgrading bus fleets.

As a result the City should be ready with priorities and funding plan to secure our share of the funding requirements.

Additional Resource Requirements

The delivery of a capital project involves costs that can be divided into two broad categories, namely direct and indirect costs. Direct costs include the construction costs and associated physical works such as utility relocations. Indirect costs include a number of non-construction related costs including preliminary investigations, testing, property acquisitions, professional design services, inspections, project management, contract administration, commissioning and record documentation, training and development of operating manuals.

The indirect costs of a project compared to the direct costs will vary with the complexity of the project and value of the project. Purchasing property and relocating expensive utilities such as natural gas lines can significantly affect the percentage of indirect costs. Experience has shown that indirect costs as a ratio of direct costs can vary between 10 and 20 percent of construction costs.

It is important in considering investments in large capital projects that existing staff resources are limited to the capacity of existing capital budgets. To ensure successful completion of the projects additional resources are required as a component of the project. Additional resources can be acquired as permanent staff appointments, temporary secondments, and consultant services. It is also important to note that all projects require a certain amount of time for City staff to ensure that the projects are administered and managed correctly. If specific staff are assigned to a capital project, then it is also possible that they have to be backfilled to ensure their normal work obligations are maintained.

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.