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.