City of Peterborough

To:	**Members of the Budget Committee**
From:	**Sandra Clancy, Director of Corporate Services**
Meeting Date:	**June 19, 2017**
Subject:	**Report CPFS17-031 2018 Debt Capacity Limit**

Purpose

A report to provide information on the City's Debt Capacity for 2018.

Recommendation

That Council approve the recommendation outlined in Report CPFS17-031 dated June 19, 2017, of the Director of Corporate Services, as follows:

That Report CPFS17-031 regarding the City's Debt Capacity Limit for 2018, be received for information.

Budget and Financial Implications

Pre-2018 Budget, and assuming debt is issued with a term of 10 years, an additional $17.8 million of tax-supported debentures and $44.2 million of non tax-supported debentures for a total of $62.0 million could be issued under the current City policy.

The City will continue to work towards its maximum debt threshold by limiting the new tax-supported debt and additional base capital levy to no more than 1% of the All-Inclusive tax increase in any year. For instance in 2018, by increasing the provision for new tax-supported debt by 1%, $13.9 million of new debt could be issued.

Background

As a result of deliberations on the 2017 Operating Budget, Council at its meeting of December 12, 2016, passed the following resolution:

> That staff provide a report on the implications of the 2018 debt capacity limit being reached, along with possible funding for capital projects.

This direction was the result of staff stating, in the 2017 Highlights Book in Report CPFS16-040, that in 2018 the City will have reached its limit within its Capital Financing Policy and would not be able to include new debt for the full 1% of the All-inclusive and that the Capital Program would be impacted.

At the time, within the Provincial Debt Policy Limit released, that was true. Since then the Province has released the updated information and, in fact, a full 1% could be issued in 2018. However, the City is still nearing the limit for future years and it is worthwhile to look at what debt capacity is available for the next few years.

Debt Limits

There are two different debt limits for the City of Peterborough to consider. The Provincial Debt Policy Limit is legislated and creates an upper threshold for an allowable level of debt that the City must live within. The policy limit is calculated the same for all municipalities across Ontario, regardless of financial health, size, and location of the municipality but the final limits vary depending on the individual municipality's revenues.

Some municipalities adopt the Provincial Limit as their own whereas other municipalities, like the City of Peterborough, create their own, self imposed, more stringent limit.

Provincial Debt Policy Limit

The provincial limit works as follows: Each year the Province calculates the City's Annual Debt Repayment Limit that limits the amount the City can pay in principle and interest payments on debt issued. The Province stipulates that a municipality may not commit more than 25 per cent of its total own-purpose revenues (Net Revenues) to service debt and other long-term obligations without obtaining prior approval from the Ontario Municipal Board.

For 2017, 25% of Net Revenues for the City equates to $49.3 million and is based on the 2015 Financial Information Return as reported to the Province. Of this amount, the City is using $14.9 million. These amounts include principal and interest repayments on debt issued and outstanding, debt issued by local boards (excluding COPHI), lease obligations and loan guarantees. This leaves additional capacity, according to the Province, of $34.4 million. According to provincial legislation, the City is using 30.2% of the 25% ($14.9 million /$49.3 million = 30.2%) of its debt capacity, or 7.55% ($14.9 million /$197.2 million = 7.55%) of its net revenues.

Using the Provinces criteria, and assuming a term of 10 years and a rate of 5.0%, the City could borrow another $265.0 million.

City Policy (called Debt Management and Capital Financing Plan) – 2012

In 2012, through Report CPFS12-011, dated April 4, 2012, Council approved a new Debt Management and Capital Financing Plan. The report set out a very intentional plan to increase the City financing available for capital.

The policy removed the requirement that "the amount of new tax-supported debt approved in any budget year will be limited to the amount of tax supported principal retired in the previous year plus any accumulated unused balance from previous years".

It established a new threshold with an annual debt repayment limit that parallels the provincial calculation based on O. Reg 403/02 with the following criteria:

- That the maximum current year annual debt repayment is based on 15% of the City's consolidated own-purpose revenues (Net Revenues), inclusive of the tax-supported current year debt payment, which is limited to 8% of the corporation's own purpose revenues.
- That, in addition to the debt charges for the current year, provision is made for any:
    - i. Debenture financing approved through by-law but for which no debt has yet been issued,
    - ii. Debenture financing approved through the Capital Budget, but for which no by-law has yet been established,
    - iii. Outstanding financial commitments beyond the normal course of business,
    - iv. Loan guarantees and significant lease obligations,
    - v. Any debt issued by, or on behalf of, the City's local boards (excluding COPHI) including mortgages, debentures or demand loans.
- That, to phase-in the new maximum debt limit, the total annual amount of new tax-supported debt charges and any increase in the capital levy provision be limited so that the impact on the residential all-inclusive tax increase does not exceed 1% per year.

For 2017 – 15% represents $29.6 million in debt principal and interest costs, with the tax supported portion of 8% amounting to $15.8 million.

Impact of New Debt Management Plan

The plan has had a significant impact on the ability to deliver capital works. The plan has:

- Accelerated the pace of capital construction that otherwise would not have been able to occur;
- Allowed the City to gain some ground on its backlog of capital projects;
- Allowed the City to take advantage of the attractive interest rates that have been available in the market place since 2012, and
- Has not completely relied on increasing debt, but also provided for increases to base capital levy.

As shown in Chart 1, since 2013 a total of $71.7 million of tax-supported financing has been added to the capital budget. Under the old policy, the additional budget for capital works would have been limited to the reinvestment of previously approved debt that had matured during that period of time.

Chart 1
Additional Capital Financing for the Years 2013 to 2017

	Capital Levy			Tax Supported (TS) Debt		
Budget year	**Capital Financing**	**Annual Change as a result of the New Policy**	**Cummulative Change $**	**Incremental Budget Provision for TS Debt P & I**	**Annual TS Debt Approved as a result of the New Policy**	**Additional Budget for Capital Works**
C1	**C2**	**C3**	**C4**	**C5**	**C6**	**C7**
						(C4 + C6)
2013	$ 1,300	$ 496.0	$ 496.0	$ 804.0	$ 7,000.0	$ 7,496.0
2014	$ 1,450	$ 500.0	$ 996.0	$ 950.0	$ 8,200.0	$ 9,196.0
2015	$ 1,450	$ -	$ 996.0	$ 1,450.0	$ 12,500.0	$ 13,496.0
2016	$ 1,504	$ -	$ 996.0	$ 1,504.0	$ 22,873.0	$ 23,869.0
2017	$ 1,551	$ -	$ 996.0	$ 1,551.0	$ 16,662.0	$ 17,658.0
2013-2017	**$ 7,255.0**	**$ 996.0**	**$ 4,480.0**	**$ 6,259.0**	**$ 67,235.0**	**$ 71,715.0**

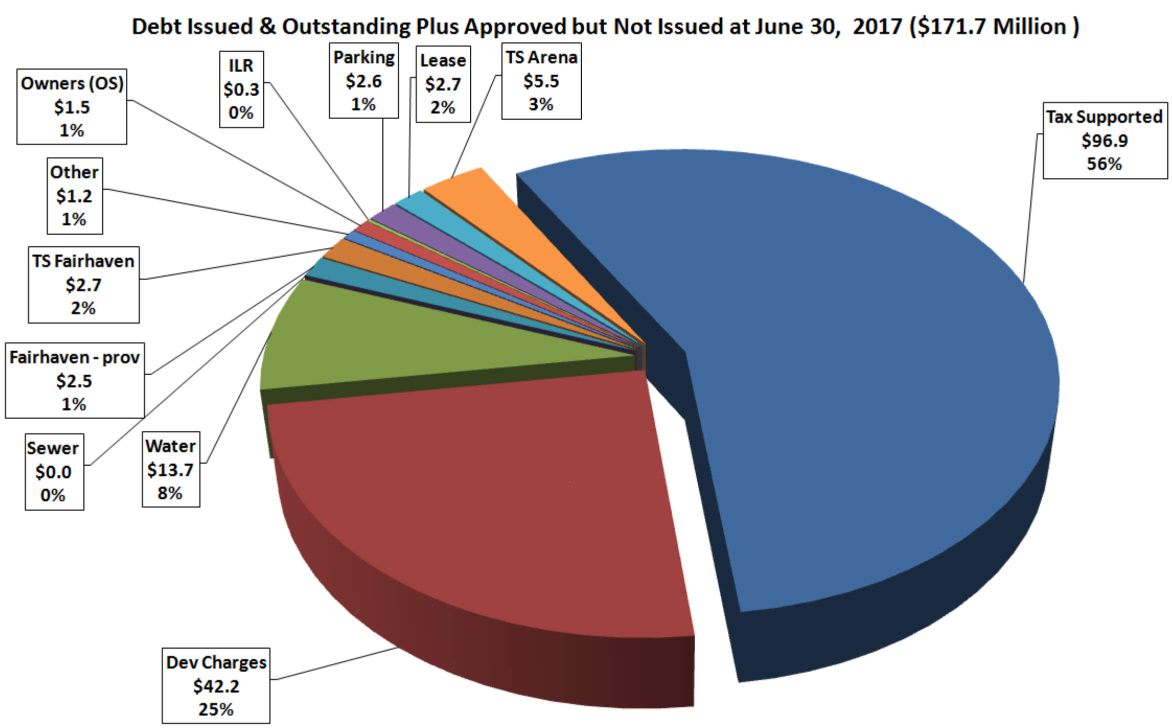
Note:
1) All dollar values in thousands
2) 2016-2017 TS Debt includes 20 year amortizations for key projects

Debt Outstanding - Issued and Approved Plus Approved but Not Issued

At the present time, including the $71.7 million, there is $106 million of debt issued and approved for which the City is locked into paying principal and interest repayments until maturity. The numbers shown in the following graphs represent outstanding principal only and do not include any interest cost.

In addition to debt issued and outstanding, $65.7 million debenture financing has been approved in previous years' budgets but has not yet been issued. Reasons may be the project has not been fully completed or the project has been delayed.

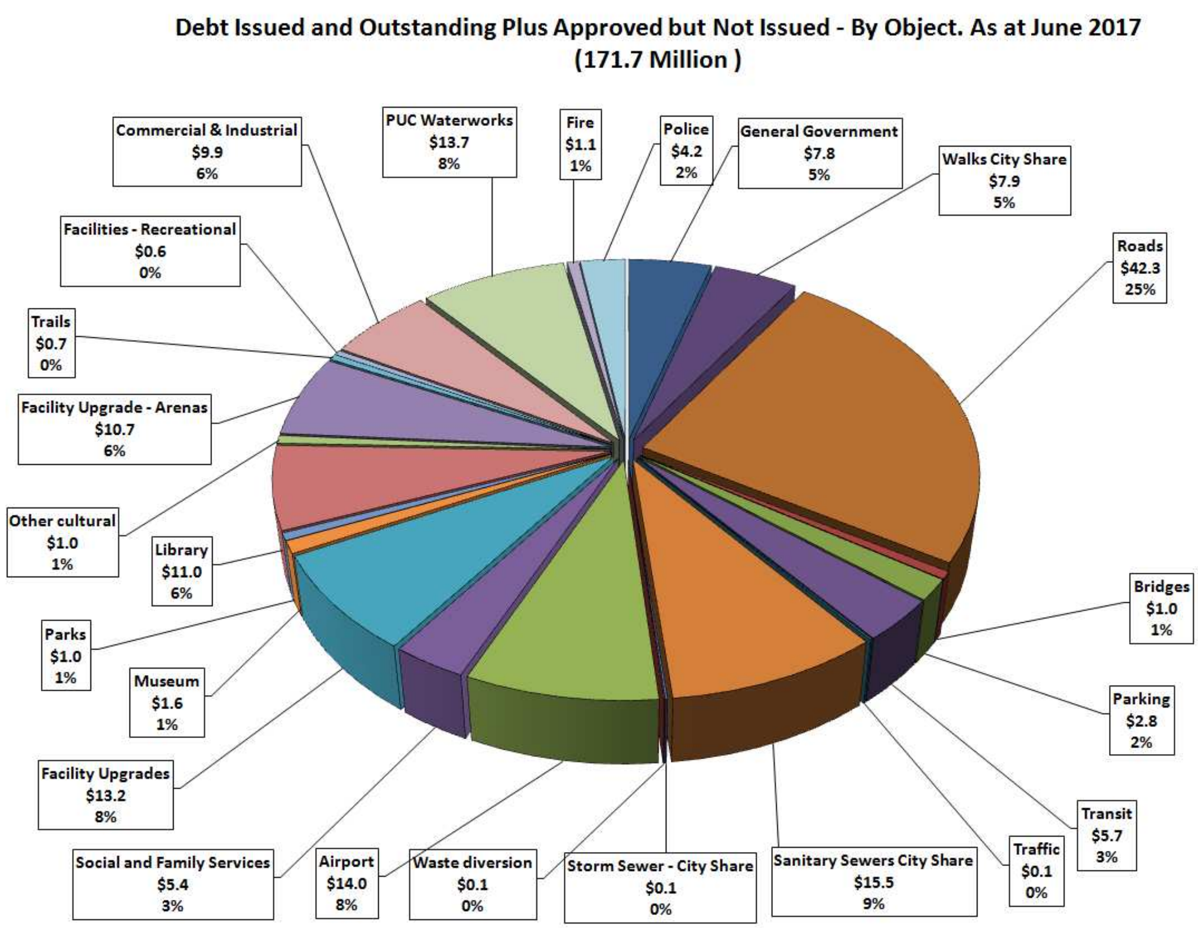
When both "Issued and Approved" and "Approved but Not Issued" types of debt are added together, the total debt load on the Municipality is $171.7 million. The first graph indicates the source that is funding the debt servicing costs.



The next graph takes the same $171.7 million "Issued and Approved" and "Approved But Not Issued" and presents the breakdown by project type, where the money was spent. As shown, the largest single area of debt is Roads, followed by Sanitary Sewers and the Airport.

The key projects that have been approved are:

- Various Airport Development projects - $20.7 million
- Public Works Relocation Project - $8.9 million
- Ashburnham -Lansdowne to Maria – $5.9 million
- Parkhill Sewage Pumping Station - $4.7 million
- WWTP - Phase III - $6.0 million



Approval of the new Debt Management Policy created additional capacity to issue new debt, but has also increased the amount of annual principal and interest that must be repaid. In 2017, the annual budget provision for tax-supported debt amounted to $11.0 million.

Potential for a Self Financing Debt Management Plan

Council's foresight and leadership in approving the 2012 debt plan, has created a systematic and intentional approach to addressing the backlog of capital works. It has not been easy, nor has it necessarily provided the financial resources to fix all of the City's infrastructure deficit but this measured approach has enabled the City to take huge strides in the right direction.

In theory, if Council were able to allocate 1% of the All-inclusive tax rate increase to debt for 10 years and the debentures matured in 10 years, Council could effectively build a sustainable base of funding for debt principal and interest payments that could transition into a 10 year, sustainable, tax-supported, self financing debt management plan. In other words, by Year 11, the Year 1 debt would mature and could be reissued within the base already provided in the Operating Budget. Through the years 2013 to 2017, Council has, in effect, completed the first five years.

Appendix A shows a tax supported capital financing plan that could be generated over a 10 year period if Council continued with the 1% capital financing in each of the Budget years 2018 – 2022. In total, $127.0 million could be generated over the 10-year period.

By 2023, (Year 11), the Year 1 debt would mature and free up that funding for a Year 11 debt issue with no additional tax supported revenue required. The same would happen in Year 12 and so on.

Even with such a plan, the buying power in years 11 would not be as much as year 10 due to:

- Construction costs that typically increase 3 – 6% annually;
- The amount of debt maturing will be less than year 10 (as the value of the 1% all-inclusive has increased each year; and
- Interest rates are bound to increase at some point.

However, to have the recurring debt maturing in a consistent manner lays the foundation for a consistent capital program.

Remaining Debt Capacity – 2018 Budget

However, a self-financing 10 year plan is also limited by the part of the City's policy that limits the tax supported principle and interest payment to 8% of the own-purpose revenues. The debt capacity available at this Report date is $17.8 million of tax-supported (TS) debt, and $44.2 million of non tax-supported (Non TS) debt for a total of $62.0 million. (To derive at these amounts, assumptions are made with respect to the term (TS = 10 years, Non TS = 20 years) of the debt and the expected interest rates available in the market place.) It was anticipated that the City would reach this limit in 2018.

Appendix B, shows a scenario that Council could plan for, still within its own policy. Some assumptions must be made as to what the own-purpose revenues will be in future years. In this scenario, a 2% annual growth increase in overall debt capacity has been assumed.

The chart assumes that in 2018, 1.0% will be approved. In 2019, approximately $1.1 million of tax-supported debt that was previously approved will be maturing. The chart assumes that the $1.1 million will be re-invested in capital works and that no 1% is applied in 2019.

For the 3 years 2020 – 2022, Council could increase tax-supported debt capacity by 0.75% and still remain within the debt limits established. In total, $111.6 million would be generated.

Discussion

Council has several options for 2018. They can:

a) Approve an additional 1% for new capital financing that continues to build upon the previous work already accomplished, and get one step closer to achieving a sustainable tax-supported capital financing base that is self supporting and can be reinvested annually over the next 10 years, with no additional burden to the taxpayer, as debentures previously issued mature.

b) Approve an additional 0.5% for new capital financing in recognition of the fact that the taxpayer is weary of tax increases and needs a break. At 0.5%, the pace of capital works will be slowed down. Approximately $7.0 million in capital projects would have to be deferred to future years compared to approving the full 1%.

c) Not approve any additional amount for new capital financing. This would mean approximately $14 million less in capital work in 2018 than in each of the previous 5 years.

Report CPFS17-033 Notice of Public Meeting – June 28, 2017 – 2018 Budget Guideline Report is also being presented to the Budget Committee on June 19, 2017. Report CPFS17-033 contains Appendix A which is Report CPFS17-037, which will be discussed by Budget Committee on July 25, 2017.

Interest rates are still relatively low and there is still a backlog of capital work to be done. It is very tempting to take advantage of this situation and continue working towards the City maximum debt limit. However, given the anticipated pressures in the Operating Budget and 2018 being the first year of the Stormwater Protection Plan, staff are recommending Option b) above for 2018. With this option, additional work is still being done but not to the full extent possible.

For 2019, a new Council will have the benefit of the debentures maturing in 2019 and may also wish to do an additional 0.5% of the All-Inclusive, which still gets the City a total of $78.3 million at the end of 2019 (Column 7 in Appendix B).

Summary

Council has done a lot of the heavy lifting. Within its own Capital Financing Policy, Council could continue with the current plan in 2018 and apply 1% of the All-Inclusive tax increase to capital. Whether, or not, Council does this, will be an issue of willingness to pay, not a limitation due to having reached the debt threshold.

Submitted by,

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Attachments:
Appendix A - Capital Financing – 1% Continues for 10 Successive Years
Appendix B - Capital Financing – Remain within Debt Capacity Limits

Appendix A
Capital Financing – 1% Continues for 10 Successive Years

Scenario 1 - Capital Financing Continues for 10 Successive Years

Capital Financing program year		1	2	3	4	5	6	7	8	9	10
Fiscal Year		**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Rate increase for Capital Financing Program		1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%
Total Capital Financing increase		1,300,000	1,450,000	1,450,000	1,504,460	1,551,400	1,582,400	1,614,100	1,646,400	1,679,300	1,712,900
TS Capital Financing		804,000	950,000	1,450,000	1,504,460	1,551,400	1,582,400	1,614,100	1,646,400	1,679,300	1,712,900
Assumed Term	10	10	10	10	10	10	10	10	10	10	10
Assumed Interest Rate	2.40%	2.60%	2.75%	2.75%	2.75%	2.25%	2.40%	2.40%	2.40%	2.40%	2.40%
Max Debt that may be Issued		$ 7,000,000	$ 8,200,000	$12,500,000	$13,000,000	$13,800,000	$13,900,000	$14,200,000	$14,500,000	$14,800,000	$15,100,000
Cumulative											
Base carrying charges		804,000	1,754,000	3,204,000	4,708,460	6,259,860	7,842,260	9,456,360	11,102,760	12,782,060	14,494,960
Max Debt (assume all 10 Yr Term)		7,000,000	15,200,000	27,700,000	40,700,000	54,500,000	68,400,000	82,600,000	97,100,000	111,900,000	127,000,000

Appendix B
Capital Financing – Remain within Debt Capacity Limits

Scenario 2 - Remain within Debt Capacity Limits

Capital Financing program year		1	2	3	4	5	6	7	8	9	10
Fiscal Year		**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Rate increase for Capital Financing Program		1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	Note 1)	0.75%	0.75%	0.75%
Total Capital Financing increase		1,300,000	1,450,000	1,450,000	1,504,460	1,551,400	1,582,400	1,130,958	1,234,800	1,259,500	1,284,700
TS Capital Financing		804,000	950,000	1,450,000	1,504,460	1,551,400	1,582,400	1,130,958	1,234,800	1,259,500	1,284,700
Assumed Term	10	10	10	10	10	10	10	10	10	10	10
Assumed Interest Rate	2.40%	2.60%	2.75%	2.75%	2.75%	2.25%	2.40%	2.40%	2.40%	2.40%	2.40%
Max Debt that may be Issued		$ 7,000,000	$ 8,200,000	$12,500,000	$13,000,000	$13,800,000	$13,900,000	$ 9,900,000	$10,900,000	$11,100,000	$11,300,000
Cumulative											
Base carrying charges		804,000	1,754,000	3,204,000	4,708,460	6,259,860	7,842,260	8,973,218	10,208,018	11,467,518	12,752,218
Max Debt (assume all 10 Yr Term)		7,000,000	15,200,000	27,700,000	40,700,000	54,500,000	68,400,000	78,300,000	89,200,000	100,300,000	111,600,000

Note: 1) Debt maturing in 2019 is expected to be $1,130,958