City of Peterborough

TO:	**Members of the Budget Committee**
FROM:	**Sandra Clancy, Director of Corporate Services**
MEETING DATE:	**April 4, 2012**
SUBJECT:	**Report CPFS12-011** **Debt Management and Capital Financing Plan**

PURPOSE

A report to recommend a new Debt Management Policy and other changes to assist in financing capital works.

RECOMMENDATIONS

That Council approve the recommendations outlined in Report CPFS12-011 dated April 4, 2012, of the Director of Corporate Services, as follows:

a) That the current 'Financing' Policy, as set out in Appendix A to Report CPFS12-011 dated April 4, 2012, be rescinded.

b) That the Debt Management Policy which will increase the maximum amount of debt the City of Peterborough can issue, as set out in Appendix B to Report CPFS12-011 dated April 4, 2012, be approved.

c) That the annual draft operating budget include a 5% increase in the capital levy provision as a means of providing more capital levy to support the capital budget requirements.

d) 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.

e) That, subject to the provisions of the City's current Purchasing By-law Council delegate to the Director of Corporate Services, as the Treasurer of the Corporation, the authority to enter into Lease Financing Agreements of an operational nature where they will not result in a Material Impact for the City.

f) That staff present a report to Council with recommendations on how to develop Capital Investment Plan and Asset Management Plan.

g) That the staff presentation presented to the April 4, 2012 Budget Committee on report CPFS12-011 be received.

BUDGET AND FINANCIAL IMPLICATIONS

Assuming debt issued with a term of 10 years, approval of this policy would allow an additional $37.0 million of tax-supported debentures to be issued and an additional $29.0 million of non tax-supported debentures for a total of $66.0 million.

The maximum limit will be phased in over several years by limiting the new tax-supported debt and additional base capital levy to no more than 1% of the tax increase in any year.

For instance in 2013, the capital levy would increase by $500,000 and $6.95 million of new debt could be issued. This is in addition to the approximately $5 million of debt capacity that is created year as existing debt principle is paid.

BACKGROUND

This report sets out a plan to increase the City financing available for capital works. The report is the result of a full analysis that Finance staff undertook to review the City's financial situation, existing debt policy, the options available and consequences of those options. The full review is attached to this report as Appendix C Debt Management Analysis and is referred to for more detail in several sections of this report.

Need to review Capital Financing

For many years there has been insufficient funding to carry out the capital works that staff and Council would like to implement. Capital projects are deferred to future years and the costs are indexed by a range of 3% - 6% per year to reflect the inflationary costs of construction.

The capital works include:

- Existing Infrastructure needs
- Future Intrastructure needs
- Various Plans approved by Council such as the Flood Reduction Master Plan, Transportation Master Plan, Sidewalk Strategic Plan, Airport Master Plan, Morrow Park Master Plan and Little Lake Master Plan
- Community Projects such as the YMCA Capital Campaign and Trent University Athletics Centre Expansion and Renovation

(For more information on the City's Infrastructure, see page 4 of Appendix C Debt Policy Analysis.)

The two main sources of funds, within the City's control, are capital levy (City operating funds to be spent on capital projects) and debt. The capital levy is limited due to pressures to keep any property tax increase to a reasonable amount and the debt is limited by the City's current Financing Policy.

While the recommendations in this report will not solve the entire capital funding issue, it will be a significant step in that direction, albeit it comes at an equally significant cost.

Proposed Change in how the City limits its Debt that can be issued

The Financing Policy, established in September 2000, is attached as Appendix A and limits the amount of new tax-supported debt approved in any budget year to the amount of tax supported principal retired in the previous year plus any accumulated unused balance from previous years. This amounts to approximately $5 million annually. The calculation includes debt issued for the City and on behalf of the Peterborough Utilities Commission and Fairhaven as the debt servicing costs for these debentures flow through the City's books.

However, the overall limit of debt the City can issue, as established by Ontario Regulation 403/02, is not just the *City* debt, but the *Corporation* including all companies in the Corporation of the City of Peterborough Financial Statements submitted to the Province. This includes debt issued by Peterborough Housing Corporation, certain lease obligations and loan guarantees. Many municipalities are using this basis for their debt policy rather than looking at *City* only.

The provincial limit works as follows: Each year the Province calculates the City's Annual Debt Repayment Limit. Rather than the City's policy that limits the amount of debt the City can issue, this limits the amount the City can pay in principle and interest payments on the 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 2012, the Province has calculated the City annual debt repayment limit at $42.6 million. Of this amount, the City is using $15.9 million (includes debt issued and outstanding, debt issued by local boards (excluding COPHI), lease obligations and loan guarantees) leaving an additional capacity, according to the Province, of $26.8 million. If the City could pay $26.8 million more each year in principle and interest payments according to the provincial limit, the amount of debt the City could issue is calculated from there. If the term of debt repayment were 10 years, the City could issue another $231 million in debt. However, that would add an additional $26.8 million to the annual operating budget or a 20.6% increase to the residential all-inclusive tax increase.

Recommendation to increase Debt Limit

The new Debt Management Policy recommends that the maximum current year annual debt repayment is based on 15% of the City's consolidated own-purpose revenues (Net Revenues), (as opposed to the Province's 25%) and that the tax-supported current year debt payment be limited to 8% of that. The City is currently using 9.3% of its debt capacity so this would move it from 9.3% to 15%.

Recommendation to Continue 5% Capital Levy Program

This Report also recommends that the annual draft operating budget include a 5% increase in the capital levy provision as a means of providing more capital levy to support the capital budget requirements.

Council has had a similar policy in the past. From 1999 to 2008, Council resolved to adopt a policy, subject to annual reviews, to increase the combined tax supported debt charge and capital levy provision, before considering City of Peterborough Holdings Inc. (COPHI) revenues, by 5%. The policy was successful in increasing the amount of capital levy available that could be used to pay for capital projects. Over the first five-year program that ran from 1999-2003, the program increased the annual capital levy by $2.1 million and an accumulative $6.1 million. Under the second 5-year 2004-2008 program, the annual base capital levy increased by a further $2.5 million by 2008 and over the period 2004 to 2008 the City generated $7.1 million more towards the capital program.

Unfortunately, for the budget years 2009 – 2011, due to budget pressures, the policy of increasing base capital levy by 5% could not be maintained, however, in 2012 Council resumed the practice and included an additional amount of $486,000 in the Draft Operating Budget to help support the Capital Budget requirements.

If Council adopts this recommendation, the City would continue some emphasis on a pay-as-you-go approach rather than completely relying on increased debt to be the source of increased capital financing.

Other Options to increase Capital Financing

Pages 17 to 21 of Appendix C, Debt Policy Analysis, describes five options that were considered by staff. Option 5 is the option being recommended.

The advantages to the combination of recommendations in this report is:

- An acceleration of the pace capital construction can occur that otherwise may not be able to occur;
- The City will gain some ground on its backlog of capital projects;
- It will allow the City to take advantage of the attractive interest rates presently available in the market place, and
- The financing plan does not completely rely on increased debt but also provides for continuing to increase the base capital levy.

Amount of Debt that can be Issued

The amount of debt that could be issued within the debt capacity will depend largely on the term of the debt and the interest rates available in the market place. The following chart provides examples using current interest rates available:

Chart 1
Amount of Debt that could be Issued - Millions

	Term In Years	Estimated Interest Rate	Tax Supported	Annual TS Debt Charges	Non Tax Supported	Annual Non TS Debt Charges	Debt Issued	Total Annual Debt Charges
	C1	C2	C3	C4	C5	C6	C7	C8
1	10	2.70%	$37.0	$4.3	$29.0	$3.4	$66.0	$7.7
2	15	3.15%	$50.4	$4.3	$39.4	$3.4	$89.8	$7.7
3	20	3.43%	$60.9	$4.3	$47.7	$3.4	$108.6	$7.7

Note: Because it is the annual debt servicing charges that are limited, Columns C4, C6 and C8 are constant, the amount of tax supported debt that can be issued (C3) and Non-Tax Supported Debt (C5) depends on the term (C1) and interest rate (C2). For instance, line 1 shows that with a term of 10 years and interest rate of 2.70%, the City could issue an additional $37.0 in tax supported debt and $29.0 million in non-tax supported debt.

Impact on Operating Budget - Tax Supported Debt Issued

Approval of the new Debt Management Policy will create additional capacity to issue new debt but will also increase the amount of annual principal and interest that must be repaid.

How quickly the new capacity is used, will depend on many factors, such as:

- The aggressiveness of new capital construction that requires debt financing;
- The construction inflation index;
- Length of term that the new debt is issued for;
- Interest rates in the market place, and
- Council's willingness to impact the all-inclusive tax rate to service new tax-supported debt issues.

Any new debt financing will continue to be approved by Council; however, as a means of limiting how quickly the new capacity could be used, staff recommend that the impact to the all-inclusive tax rate as a result of issuing new tax-supported debentures <u>and</u> the increase in base capital levy not exceed 1% per year. For 2012, 1% equates to roughly $1.3 million. At a rate of 1% per year, increases will occur in years 1 through 4 until the new debt capacity limit is reached.

<u>Example 1:</u> Council chooses to increase base capital levy by $500,000 in 2013. Then $800,000 would be available in 2013 to service additional tax-supported debt. Capitalized, the $800,000 equates to approximately $6,950,000 of additional TS debt with a term of 10 years. The additional $800,000 expense for debt principle and interest payments would then be added to the Operating Budget for the next 10 years.

<u>Example 2:</u> Council chooses not to increase base capital levy in 2013. Then $1,300,000 would be available to service additional tax-supported debt. Capitalized, the $1,300,000 equates to approximately $11,300,000 of additional TS debt with a term of 10 years. The additional $1,300,000 expense for debt principle and interest payments would then be added to the Operating Budget for the next 10 years.

Lease Financing Agreements

The debt capacity calculation includes lease financing agreements. However, only those lease agreements that are of a material nature as determined by the Treasurer, as delegated by Council, need be included. A lease financing agreement is considered material if the costs or risks associated with the agreement have a significant effect on the debt capacity calculation.

It is recommended that such delegation of authority be given to the Director of Corporate Services as the Treasurer of the Corporation.

Engineering Staff Resources

The majority of the large infrastructure capital works is managed by the City's Design and Construction Division within Utility Services. Existing staff resources are not sufficient to deliver the amount of work that is referenced in this report. Contracting out the services may be a partial solution however contracts still need to be effectively managed.

If the recommendations in this report are approved, future Capital Budgets Work will include adequate funding for staff resources, and the CAO would use his delegated authority to increase the staff resources as required to implement the program.

A staff presentation will be made at the April 4, 2012 Budget Committee meeting to further speak to the topics presented in this report and answer any questions that the Committee may have.

SUMMARY

Approval of the new Debt Management Policy and other recommendations in this report will allow the City to move forward with its capital program at a more timely pace while the annual debt repayment amounts are still reasonable. It will not solve all the capital financing issues of the City but it will be a positive step forward.

Submitted by,

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Appendix A – September 2000 Financing Policy

Appendix B – New Debt Management Policy

Appendix C – Debt Policy Analysis

Appendix A

September 2000 Financing Policy

DIVISION: **FINANCIAL SERVICES** **SECTION 2**

POLICY TITLE: **FINANCING**

AUTHORITY: **SECTIONS 167, 179, 186, 187, 188 AND 210**
OF THE MUNICIPAL ACT
CITY COUNCIL APPROVAL OF REPORT FAFS00-017
Dated September 25, 2000

2.1 TEMPORARY LOANS

2.1.1 A council may authorize the Mayor and Treasurer to borrow such sums as the council considers necessary to meet, until taxes are collected and other revenues are received, the current expenditures of the City of Peterborough ("the City").

2.1.2 If the City has, through a by-law, approved an undertaking to be financed in whole or in part by incurring long-term debt, council may authorize temporary borrowing to meet expenditures made in connection with the project.

2.1.3 Temporary loans shall be evidenced by a bankers' acceptance or a promissory note that is sealed with the City's corporate seal and signed by the Mayor and Treasurer.

2.1.4 The signature of any person that is authorized to sign promissory notes or bankers' acceptances may be printed, engraved, lithographed or otherwise mechanically reproduced.

2.1.5 The Treasurer is hereby authorized and directed to apply in payment of all sums borrowed, pursuant to this authority, the revenues of the City as and when such revenues are received.

2.1.6 The amount that may be borrowed at any one time, for the purposes mentioned in this section, together with the total of any similar borrowings that have not been repaid, shall not, without the approval of the Ontario Municipal Board, exceed:

(a) From January 1st to September 30th of the year - 50 per cent of the total estimated revenues of the City as set forth in estimates adopted for the year, and;

(b) From October 1st to December 31st - 25 per cent of the total estimated revenues of the City.

2.1.7 Until estimated revenues for the current year are approved, the limitations upon borrowing that are prescribed directly above shall temporarily be calculated upon the estimated revenues of the City for the preceding year.

2.1.8 Estimated revenues referenced in 2.1.6 do not include cash flow derivable or derived from:

A. borrowings or issues of debentures
B. a surplus, including arrears of levies, and;
C. transfers from the capital fund, reserve funds or reserves

2.2 DEBENTURES

2.2.1 A debenture shall bear:

A. the City's seal, and;

B. the signatures of:

(i) the head of council, or another person authorized to sign through a by-law of the City, and;
(ii) the Treasurer.

2.2.2 The seal and signatures referred to in section **2.2** may be printed, lithographed, engraved or otherwise mechanically reproduced.

2.2.3 The City will use the services of a Fiscal Agent to sell debentures and determine the interest rate and method of calculating the rate of interest, that the debentures shall bear when issued. The Fiscal Agent shall be appointed by Council for a five year term based on a proposal call. The term can be extended to a maximum term of ten years subject to satisfactory rate negotiations and the approval of Council.

2.3 LONG TERM DEBT REPAYMENT LIMITS

2.3.1 The City's maximum annual debt repayment limit shall equal the amount established by the Province of Ontario, and updated by the Treasurer**.**

The City shall use the most recent limit provided to it by the Ministry to determine whether Ontario Municipal Board approval is required in respect of the following categories of financial obligations:

A. Long-term debt assumed, for which repayment will be required beyond the term for which the council was elected, and;

B. Other financial commitments, liabilities and contractual obligations, for which payment may be required beyond the term for which the council was elected, including financial commitments to hospitals and universities.

2.3.2 All by-laws passed that authorize capital works requiring long-term financial commitments, and all debenture by-laws passed, shall be reviewed by the Treasurer prior to approval so that the ability to assume the proposed obligation can be confirmed.

2.4 INTERNAL RULES AND RESTRICTIONS

2.4.1 As evidence that the Treasurer has updated the annual repayment limit before Council authorizes any specific work that would require a long term debt or financial obligation, the following preamble must be added to debenture by-laws:

> *"AND WHEREAS the Treasurer has calculated an updated limit for the Corporation of the City of Peterborough using its most recent financial debt and obligation limit determined by the Ministry of Municipal Affairs in accordance with the provisions of **Ontario Regulation 799/94 (the "Limit")**;*
>
> *AND WHEREAS the Treasurer has calculated the estimated annual amount payment in respect of the portion of the capital work described in this by-law to be financed by debenture and has determined that such estimated annual amount payable will not cause the Corporation's total annual debt repayment to exceed the Limit."*

2.4.2 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.

2.4.3 The annual budgeted increases for total tax-supported principal and interest repayments, plus the capital levy provision, will be established by Council as part of the annual budget guideline establishment process.

2.4.4 The amount of any new debt, in a given year, that is to be financed from sources other than taxation as follows is limited as follows:

A. **Parking Reserve Fund** - limited to the estimated annual repayment amounts that can be financed from any uncommitted balance in the Parking Reserve Fund plus the estimated parking charges to be collected during the term of the proposed new debt

B. **Development Charge Reserve Fund** - limited to the estimated annual repayment amounts that can be financed from any uncommitted balance in the Development Charge Reserve Fund plus the estimated development charges to be collected during the term of the proposed new debt

C. **Sewer Surcharge Reserve Fund** - limited to the estimated annual repayment amounts that can be financed from any uncommitted balance in the Sewer Surcharge Reserve Fund plus the estimated amounts to be raised from the sewer and sewer service rates to be imposed during the term of the proposed new debt

D. **Waste Management Reserve Fund** - limited to the estimated annual repayment amounts that can be financed from any uncommitted balance in the Waste

Management Reserve Fund plus the estimated amounts to be raised from tipping fees and garbage tax levies during the term of the proposed new debt that can be transferred to the fund

E. **Industrial Reserve Fund** - limited to the estimated annual principal repayment amounts that can be financed from any uncommitted balance in the Industrial Land Reserve Fund plus the estimated proceeds from future land sales

2.4.5 If, in any budget year, estimated non-tax revenues identified in *2.4.4* are insufficient to meet annual obligations for debt that has already been issued, the shortfall shall be considered as part of the annual tax-supported debt charge allocation which forms part of the capital levy formula.

2.5 ADDITIONAL SOURCES OF FINANCING

2.5.1 The City may explore, where appropriate, other methods of financing capital projects. including the following:

(a) Borrowing internally from reserve funds (**Section 167** of **Municipal Act and Ontario Regulation 438/97**)

(b) Fund-raising

(c) Partnerships with the private sector for the construction of facilities

(d) Sponsorship of facilities by private sector firms, and;

(e) User pay systems.

2.6 ULTRA VIRES

2.6.1 **Sections 167, 179, 186, 187, 188 and 210 of the Municipal Act** as well as **Ontario Regulation 799/94** shall take precedence over this policy and any changes to it.

Appendix B

New Debt Management Policy

City of Peterborough

DRAFT POLICY

DEBT MANAGEMENT

Policy Type:	Administration	**Effective Date:**	
Department:	Corporate Services	**Approval Level:**	Council
Division:	Financial Services	**Policy #:**	
Section/Facility:	Capital Financing and Debt	**Revision #:**	N/A

1.0 PURPOSE

1.1 This policy establishes:

.1 The goals that must be adhered to before entering into any Debt.
.2 The Annual Debt Repayment Limits for the Corporation of the City of Peterborough.
.3 The authority for Temporary Borrowing.

1.2 This policy facilitates compliance with The Municipal Act, 2001, s.401-s.417 and related Ontario Regulations, as listed in Section 5.1 of this policy.

2.0 APPLICATION

2.1 This policy and its related procedure applies to all Debt, including Lease Financing Agreements, and Debt payments entered into by the City.

2.2 This policy and its related procedure applies to all persons responsible for overseeing, developing, administering, processing, and/or entering into Debt agreements on behalf of the City, its agencies, boards, or commissions.

3.0 DEFINITIONS/ACRONYMS (As Required)

Act - The Municipal Act, 2001, as amended.

All Inclusive Tax Increase - The annual increase in the combined municipal and education tax, plus the sewer surcharge rates.

3.0 DEFINITIONS/ACRONYMS (As Required)

Annual Debt Repayment Limit - The maximum amount of annual debt servicing costs that a municipality can undertake or guarantee without seeking the approval of the Ontario Municipal Board.

Capital Levy - The amount of money raised through taxation that appears in the current year Operating Budget that is transferred to the capital fund to be used to help pay for capital projects.

City - The Corporation of the City of Peterborough, its agencies, boards and commissions, and in accordance with the City's Consolidated Financial Statements, those organizations accountable for the administration of their financial affairs and resources to the City and which are owned or controlled by the City.

Debenture - A formal written obligation to repay specific sums of money on certain dates. Debentures are direct, unsecured and unsubordinated obligations of a municipality and must rank equally in respect of payment of principal and interest.

Debt - Any obligation for the payment of money. The City considers debt to consist of debentures, cash loans from financial institutions, capital leases, debenture financing approved through by-law but for which no debt has yet been issued, debenture financing approved through the Capital Budget but for which no by-law has yet been established, outstanding financial commitments, loan guarantees, and any debt issued by, or on behalf of the City, including mortgages, debentures or demand loans.

Lease Financing Agreement - A financial agreement, in accordance with Ontario Regulation 653/05 of the Act, that a municipality may enter into for the purpose of obtaining long-term financing of a capital undertaking of the municipality.

Long-Term Debt - Any debt for which the repayment of any portion of the principal is due beyond one year.

Material Impact - Under Ontario Regulation 653/05 of the Act, a lease financing agreement has a material impact on a municipality if the costs or risks associated with the agreement significantly affect the municipality's debt and financial limit determined in accordance with Ontario Regulation 403/02 made under the Act, or would reasonably be expected to have a significant effect on that limit.

3.0 DEFINITIONS/ACRONYMS (As Required)

Net Revenues - Total City consolidated revenues less grants from other levels of government less sales of land less development charges earned. These revenues also do not include donations of tangible capital assets.

Tax-Supported Debt - Debt that is to be recovered from general tax revenues.

Temporary Borrowing - Debt for which the repayment of the entire principal is due within one year or in the case of funding for a capital project, borrowing until Long-Term Debt to cover the costs is obtained or issued.

4.0 POLICY STATEMENT(S)

4.1 Before entering into any Debt, including Lease Financing Agreements, the following goals must be adhered to:

.1 The Debt will be managed in a manner consistent with other long-term planning, financial and management objectives.

.2 Consideration will be given to its impact on future ratepayers as a means to achieve an appropriate balance between Debt and other forms of funding.

.3 Debt will be managed in a manner to limit financial risk exposure.

.4 The timing, type, and term of Debt will be determined with a view to minimizing long-term cost.

.5 The term of Debt will be limited to the term of the useful life of the particular asset, but no greater than 40 years.

.6 Debt will be managed in a manner to maintain the best possible credit rating by a bond-rating agency used by the City.

.7 A category of Lease Financing Agreements may be relied upon for non-material or operational leases where in the opinion of the Treasurer, as delegated by Council through this Policy, will not result in a Material Impact for the City.

4.0 POLICY STATEMENT(S)

4.2 The City's maximum Annual Debt Repayment Limit will be 15% of the City's Net Revenues, inclusive of the tax-supported current year Debt payment, which is limited to 8% of Net Revenues.

.1 Further, the City's total annual amount of new Tax-Supported Debt charges and any increase in the Base Capital Levy provision will be limited so that the impact on the All Inclusive Tax Increase does not exceed 1%.

4.3 City Council authorizes the Mayor and Treasurer to borrow funds on a temporary basis, in accordance with the definition for Temporary Borrowing under this policy and sections 405-407 of the Act, under the following conditions:

.1 To meet the current expenditures of the City until taxes are collected or other revenues received.

.2 To meet expenditures of a project until Long-Term Debt has been secured.

5.0 APPENDIX, RELATED POLICIES, PROCEDURES & LINKS

5.1 Pertinent Resources

Municipal Act, 2001

Ontario Regulation 247/01 - Variable Interest Rate Debentures and Foreign Currency Borrowing

Ontario Regulation 276/02 - Bank Loans

Ontario Regulation 278/02 - Construction Financing

Ontario Regulation 403/02 - Debt and Financial Obligation Limits

Ontario Regulation 653/05 - Debt Related Financial Instruments and Financial Agreements

Purchasing Policy By-Law (By-Law No. 10-132)

5.2 Related Policies

5.3 Related Procedures

Debt Management Procedure

5.4 Related Forms

N/A

5.5 Miscellaneous

Purchasing By-law

6.0 AMENDMENTS/ REVIEWS

Next Review Date	

Date (yyyy-mm-dd)	Section(s) Amended	Comments

Appendix C

To Report CPFS12-011- “Debt Management and Capital Financing Plan”

Debt Policy Analysis

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This Debt Policy Analysis contains the full analysis that staff undertook before recommending the new Debt Management Policy as set out in Appendix B to Report CPFS12-011 Capital Financing Plan, dated April 4, 2012.

Current Financing Policy Established in 2000

The current policy (see Appendix A to Report CPFS12-011) was established in September of 2000 and placed restrictions on how much Tax Supported Debt could be used to finance capital projects. Tax Supported Debt is defined as debt incurred for which the resulting principal and interest would be paid from general tax revenues as opposed to other sources such as user fees, development charges, and sewer surcharge revenues.

The key section of the 2000 policy read as follows:

> *2.4.2 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.*
>
> *2.4.3 The annual budgeted increases for total tax-supported principal and interest repayments, plus the capital levy provision, will be established by Council as part of the annual budget guideline establishment process.*
>
> *2.4.5 If, in any budget year, estimated non-tax revenues are insufficient to meet annual obligations for debt that has already been issued, the shortfall shall be considered as part of the annual tax-supported debt charge allocation which forms part of the capital levy formula.*

Amendments Needed to the Current Financing Policy

The current Financing Policy has worked reasonably well since 2000, and has ensured a healthy balance between our ability to implement essential capital programs while keeping debt levels at acceptable levels and limiting tax increases. But the cost of implementing new major infrastructure capital programs within reasonable time frames, while trying to maintain the assets we already have, plus Councils' stated desire to implement various plans and studies that have - or are about to be approved – all require revision to the policy. The capital works include:

- Existing Infrastructure needs;
- Future Intrastructure needs;
- Various Plans approved by Council such as the Flood Reduction Master Plan, Transportation Master Plan, Sidewalk Strategic Plan, Airport Master Plan, Morrow Park Master Plan and Little Lake Master Plan, and
- Community Projects such as the YMCA Capital Campaign and Trent University Athletics Centre Expansion and Renovation.

In addition, Council will be considering providing services to annexed lands which could result in a significant City contribution.

It is an appropriate time to review the option of increasing debt as long-term interest rates are at record lows and the cost of borrowing is less than the annual indexing of construction costs.

Infrastructure Deficit – Province Wide - $123 Billion

The City of Peterborough capital financing problem is becoming common place amongst Canadian municipalities.

In 2007, the Federation of Canadian Municipalities published a document entitled 'Danger Ahead: The Coming Collapse of Canada's Municipal Infrastructure'. Written in a context that identifies municipalities as building, owning and maintaining most of the infrastructure that supports our economy and quality of life, the report paints a disturbing reality:

- Most of the infrastructure was built between the 50's and the 70's and is now due for replacement.
- The shift in ownership and the management of infrastructure has been significant. In 1961, the federal, provincial and municipal ownership share was estimated to be approximately 23.9%, 45.3% and 30.9% respectively. In 2002 the Federal governments share had dropped from 23.9% to 6.8%, and the

municipal share had grown to 52.4%, in recent years estimates have pegged the municipal ownership figure at closer to 70%. The shift is a result of a combination of the transfer of assets from the provincial and federal governments as well as the increased demand of municipal services.

- On a national scale, the infrastructure deficit was estimated to be $12 billion in 1985, $60 billion in 2003 and $123 billion in 2007**.**

What does the term Infrastructure Deficit mean?

The term ‘Infrastructure deficit’ refers to the backlog of investment in municipal infrastructure. It is the amount of money required to maintain and upgrade existing infrastructure to a minimum acceptable level of operation over the service life of the capital asset. Expressed another way, it is the additional investment needed to repair and prevent deterioration of existing municipal infrastructure.

City’s Infrastructure - $1.5 Billion

The City owns assets worth about $1.5 billion as shown on Table 1.

Table 1
Major Components of the City's Infrastructure

	Asset Description	Units	Units of Measure	Estimated Replacement Cost
Roadway Systems	Major Bridges (>200 m2)	15	Each	
	Minor Bridges (<200 m2)	31	Each	
	Concrete Culverts	7	Each	
	CSP Culverts	9	Each	
	Arterial Roads (surface)	100	KM's	$ 494,000,000
	Collector Roads (surface)	73	KM's	
	Local Roads (surface)	220	KM's	
	Concrete Sidewalks	464	KM's	
	Curbs & Gutters	592	KM's	
Storm	Large Storm Sewers	199	KM's	$ 207,000,000
	Small Storm Sewers	383	KM's	
Sanitary	Sani Sewer Forcemains	15	KM's	
	Sani Sewer Gravity Local Mains	408	KM's	
	Sani Sewer Gravity Trunk Mains	102	KM's	$ 547,000,000
	Pumping Stations	11		
	Waste Water Treatment Plant	1		
Buildings	Major Buildings (>500m2)	29	Each	
	Minor Buildings (<500 m2)	56	Each	$ 220,000,000
	Rental Buildings	36	Each	
				$ 1,468,000,000 ++

Note:
Replacement cost - the amount of cash or other consideration that would be needed to acquire an asset having equivalent service potential to that of the asset presently owned. It would take into account changes in technology. It would be based on the estimated present cost of constructing the existing asset or component of the asset by the same or (similar method) of construction using the same or similar materials.

In addition to the assets shown on Table 1, Council is ultimately responsible for capital assets of its local boards. Some of the more significant assets include:

- 2 libraries
- 1 zoo
- 1 home for the aged
- 1 health unit
- 1 water treatment plant plus 412 km's of water distribution network
- 818 units of housing stock

The historical cost on the City's consolidated books at the end of 2010 amounted to $872 million. However, for long term financial planning purposes, replacement cost as identified in Table 1, should be used.

In addition to the expectations of the taxpayers, there are numerous Acts and Standards that that include legislated requirements to maintain some of the assets. Some of these were referenced during the April 2012 presentations made to the Budget Committee and include Ministry of Transportation Standards, the Highway Traffic Act, the Environmental Protection Act, the Clean Water Act, the Water Opportunities and Water Conservation Act, Minimum Maintenance Standards, etc. Each, in their own way, imposes demands on Council to ensure the City's capital assets are maintained to meet certain levels of service.

2012 Capital Budget Funding Sources

There are limited funding sources for capital projects which, when applied to the cost of the individual projects, leave an amount that must be funded from annual tax revenues (capital levy) or tax-supported debt.

Using 2012 as an example, the capital budget proposed $51.6 million expenditures funded from a number of sources follows:

Description	**Amount (Millions)**
Total capital project requests	$51.6
External funding (Federal Gas Tax, grants and any	($5.9)
Funding from reserves and development charges	($27.2)
Funding from debenture financing other than tax-	($4.9)
Balance to be funded	**$13.6**
Capital Levy	$7.4
Tax Supported debt	$6.2

Funding Challenges

For many years there has been insufficient funding and staffing to carry out the capital works that staff and Council would like to implement in any given year. In addition, proper replacement provisions for existing assets have not been included in the capital estimates in most cases. To make each year's capital program fit within available financing many capital projects are pushed out to future years. Costs are indexed by a range of 3% - 6% per year to reflect the inflationary costs of construction. This annual deferral of many important projects is creating a bubble effect that can't be sustained.

Over the years, some positive steps have been taken to increase the amount of capital financing available. From 1999 to 2008, Council adopted a policy, subject to annual reviews, to increase the combined tax supported debt charge and capital levy provision, before considering City of Peterborough Holdings Inc. (COPHI) revenues, by 5%. The policy was successful in increasing the amount of capital levy available that could be used to pay for capital projects. Over the first five-year program that ran from 1999-2003, the program increased the annual capital levy by $2.1 million and an accumulative $6.1 million. Under the second 5-year 2004-2008 program, the annual base capital levy increased by a further $2.5 million by 2008 and over the period 2004 to 2008 the City generated $7.1 million more towards the capital program.

Unfortunately, for the budget years 2009 – 2011, due to budget pressures, the policy of increasing base capital levy by 5% could not be maintained. In 2012, however, Council resumed the practice and directed staff to include an additional $486,000 in the Draft 2012 Operating Budget to help support the Capital Budget requirements. Council also established an all-inclusive 2.5% rate increase, however, and the additional $486,000 had to be accommodated with the 2.5%.

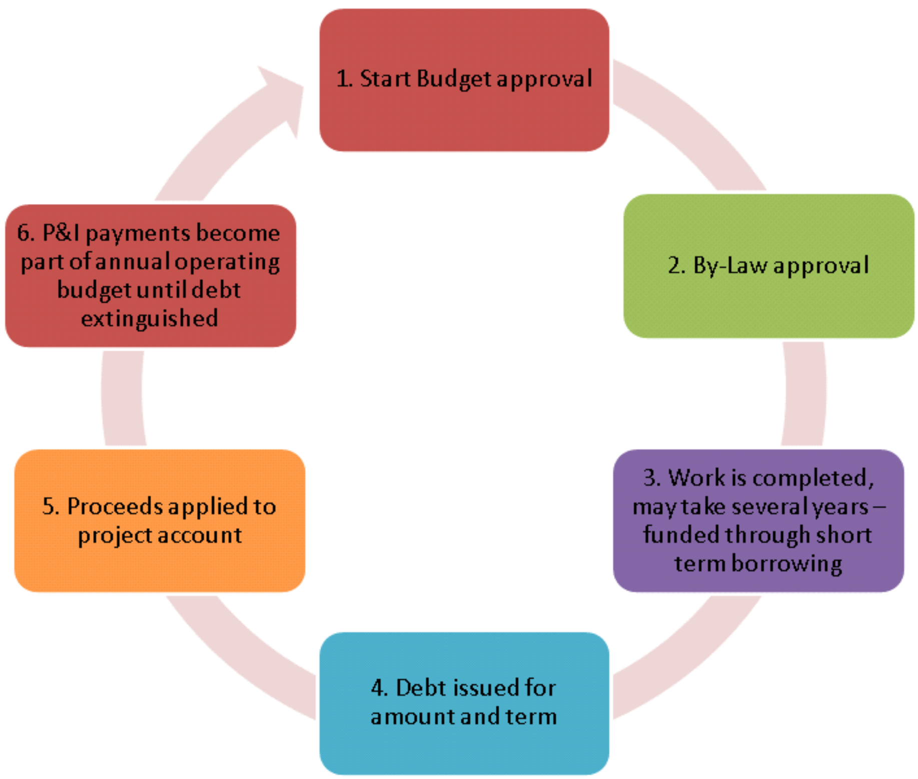
Indicative of the fact that something more has to be done, Council has had to approve the use 'special' tax-supported debt - intentionally choosing to approve debt beyond what is allowed according to the existing policy such as the Airport Expansion Project and the Police Radio Project.

Debt Approval Cycle

Debt includes long-term debt and certain lease obligations of the City and its local boards. As stipulated in the Municipal Act, 2001, long-term debt can only be used to finance capital assets. The City issues debt that is repaid from a variety of sources including water, wastewater and parking user rates, development charges, provincial/federal gas tax, user fees, property taxation and local improvements.

The following graph gives a high level overview of how debt is typically incurred through the Capital budget process.

Graph 1
Debt Approval Cycle

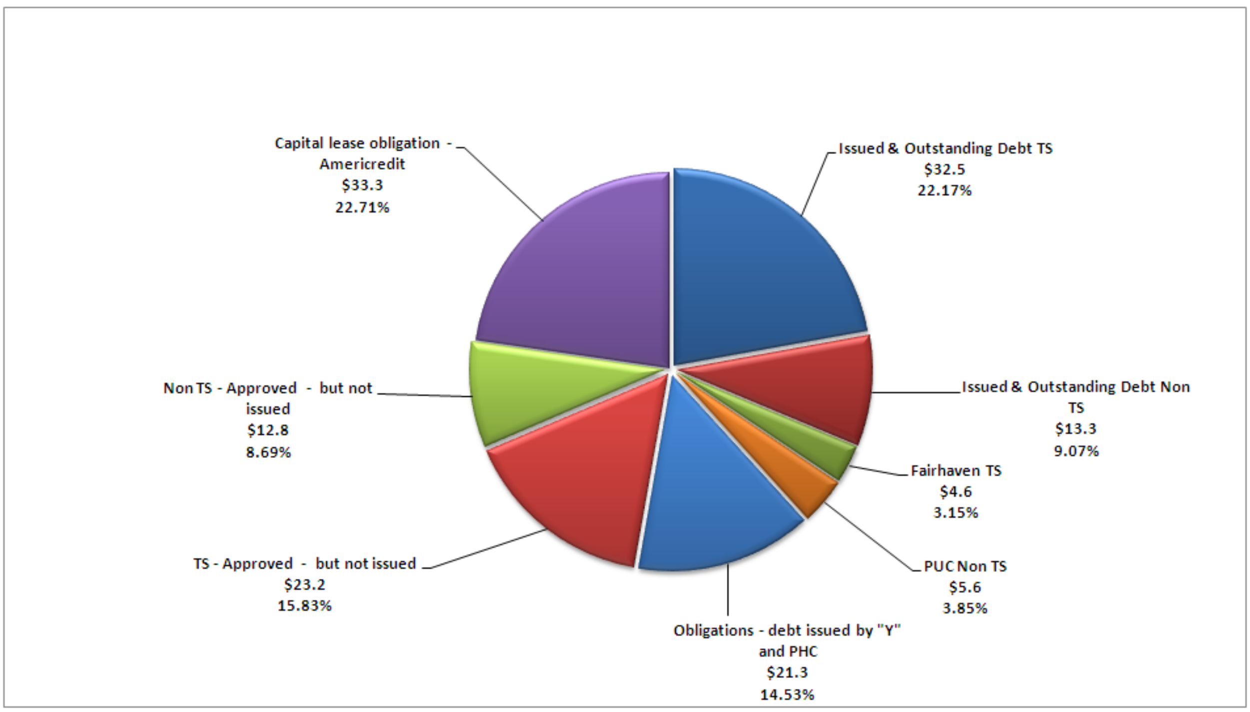


Debt Levels

The annual Budget Highlights book, provides updates to Council on City debt that has been issued and is outstanding (2012 – $56.1 million, 2011 - $64.0 million), plus any debt approved but not issued (2012 - $34.5 million, 2011 - $22.8 million) for a total of $90.6 million (2011 - $86.8 million). The amounts referenced include debt issued on behalf of the Peterborough Utilities Commission and Fairhaven as the debt servicing costs for these debentures flow through the City's books.

However, when it comes to the issue of debt capacity as established by Ontario Regulation 403/02, it is not just the *City* that must be considered, but the *Corporation* including all companies reflected in the Corporation of the City of Peterborough Financial Statements submitted to the Province. This includes debt issued by Peterborough Housing Corporation, certain lease obligations and loan guarantees. All together, the consolidated debt amounts to $146.6 million for 2012 as shown in Graph 2.

Graph 2
2012 Debt Issued & Outstanding PLUS Approved But Not Issued PLUS Other Financial Commitments - $146.6 Million



Debt financing that has been approved through the budget process, but not yet issued is distinguished between those amounts whose debt servicing costs will be paid for through the assessment base, (tax-supported (TS)), and those amounts whose debt servicing costs will be funded from other sources (Non TS).

Sample Debt Repayment Schedule

Once debt has been issued, principal and interest payments must be made to the debt holder in accordance with payment schedules established at the time the debt is issued. For budgeting purposes, principal and interest charges become an expense in the operating budget. The amount of principal and interest depends on the debenture amount, the debt instrument type, interest rate, and term.

Chart 1 below illustrates the principal and interest payment for a $1.0 million issue, at 2.7% interest rate, for a ten year term. The Chart shows an annual principal and interest payment of $114,219 will need to be included in the annual operating budget for a ten year period. Over the ten year period $142,185 interest will be paid to the debt holder in addition to the principal repayment.

Chart 1
Sample Debenture Schedule

Principal	$1,000,000
Annual Interest rate	2.700%
Term in years	10
Payment per annum	$114,219
Start date	January 1, 2013
End Date	January 1, 2023

Year	Period	Opening	Principle	Interest	Total Pmt	Closing
2013	1	1,000,000	88,306	25,913	114,219	911,694
2014	2	911,694	90,720	23,499	114,219	820,974
2015	3	820,974	93,200	21,019	114,219	727,774
2016	4	727,774	95,748	18,471	114,219	632,026
2017	5	632,026	98,365	15,853	114,219	533,661
2018	6	533,661	101,054	13,164	114,219	432,607
2019	7	432,607	103,817	10,402	114,219	328,790
2020	8	328,790	106,655	7,564	114,219	222,136
2021	9	222,136	109,570	4,648	114,219	112,565
2022	10	112,565	112,565	1,653	114,219	0
Total			1,000,000	142,185	1,142,185	

Annual Debt Repayment – Provincial Legislation

Each year the Province calculates the City's Annual Debt Repayment Limit. 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 2012, the Province has calculated the City's annual debt repayment limit at $42.6 million. Of this amount, the City is using $15.9 million (includes principal and interest repayments on debt issued and outstanding, debt issued by local boards (excluding COPHI), lease obligations and loan guarantees) leaving an additional capacity, according to the Province, of $26.8 million. According to provincial legislation, the City is using 36% ($15.9 million /$42.6 million = 36%) of its debt capacity.

Technically, the City could issue an additional $231 million of debt, for a ten-year term at 2.80% interest and still be within the $42.6 million principal and interest limit imposed by the Provincial Limit.

Factors to be considered before changing the Debt Policy

There are a number of factors that should be considered when amending a debt policy.

The Net Financial Assets Ratio

In Peterborough, much focus has traditionally been placed on debt outstanding particularly by the media during election campaigns. The inference has been by some that if debt levels have increased over a Council term, then Council of the day – and particularly the Mayor - has demonstrated poor financial controls. During one campaign, the incumbent Mayor was cast as the "Duchess of Debt".

The amount of debt outstanding has little meaning, however, without considering available financial assets and other liabilities. The Net Financial Assets Ratio is a broader measure of indebtedness than the level of borrowing as it includes all of the liabilities of the municipality and measures the extent to which the liabilities could be met from operating revenues.

The Net Financial Assets Ratio is calculated as total assets minus liabilities as a percentage of own source revenues. This ratio indicates the extent to which financial liabilities could be met by its operating revenue. When this ratio is increasing from one year to the next it indicates that the municipality's capacity to meet its financial obligations from operating revenue is strengthening. A ratio less than zero, indicates that total liabilities exceed total assets. There is no optimal number or range for this indicator, however, what is important is that each municipality understands and is comfortable with the ratio it has and it has been determined based on future needs and long term financial sustainability.

The City's Net Financial Assets Ratio for 2010 was 53% (2009 – 51%), which means that the City is well positioned to carry additional debt. By comparison, the average municipality would mostly likely be closer to a breakeven position, or even a Net Liabilities position, which means that their financial liabilities exceed their financial assets.

Growth and Development

The City has growth and development either happening or about to happen at numerous geographic locations within the City simultaneously. This presents some significant funding challenges.

The following is a quick synopsis of how the City approaches such issues:

Current Practice

- Under the Development Charges Act, 1997 the City charges DCs to new construction units to fund the costs of growth to the full extent permitted in the legislation and our DC By-laws.

- Growth related projects are undertaken as DC's are collected, consistent with the DC Background Study.

- Growth related projects can proceed in advance of collection of DC's subject to availability of funds/financing, either through short term financing or issuing debt with the principal and interest funded from DC's.

- Other financing methods are explored with developers to fund growth related projects that are not eligible for DC's.

Public-Private Partnerships, Including Joint Partnerships with Other Organizations

To reduce costs and ultimate reliance on debt financing, Council should consider all available options including public-private partnerships and joint partnerships with other organizations. Such arrangements are:

- Permissible under existing policy

- Most suited to assist in financing strategic initiatives and enhancements to the quality of life in the City.

Strategic Initiatives include capital projects and additional operating requirements that enhance the quality of life in the City, respond to changes in demand for services, enable organizational efficiency, or are required because of senior levels of government regulation. These items are not related to growth nor are they required to maintain existing assets or programs. Examples: Arenas, Peterborough Sport and Wellness Centre.

Current Practice

- Projects are advanced based on their priority as established by Council.

- Public-Private Partnerships and/or Joint Partnerships with Other Organizations are presented to Council such as the Sir Sandford Fleming College sport fields.

Additional Proposed

- Dedicated sources of funding, including confirmed funding from other levels of government, are considered as the first source of financing.

- Business case analysis, including the identification and analysis of the impact of future operating costs must be completed.

Credit Rating

Each year Standard & Poor’s (S&P’s) assigns a credit rating to the City based on its qualitative and quantitative analysis of a range of financial, economic, managerial, and institutional factors. The analysis centre’s around eight major components:

- Institutional framework;
- Economy;
- Financial management;
- Budgetary flexibility;
- Budgetary performance;
- Liquidity;
- Debt burden; and
- Contingent liabilities.

In their report issued October 2011, S&P's confirmed the City's credit rating of AA-/Stable. In making its assessment, S&P identified the following strengths and weaknesses:

Strengths:

- Strong liquidity
- Consistently robust operating surpluses

Weaknesses:

- Constraints on economic growth
- Financial flexibility weakening

In providing its 'outlook' S&P made the following comments:

> "The stable outlook reflects Standard & Poor's expectation that Peterborough will maintain strong liquidity, operating performance will remain robust, and debt levels will not increase significantly beyond current expectations during our forecast horizon. An upgrade or outlook revision to positive would require meaningful growth and diversification of the economy. We could lower the rating or revise the outlook to negative if there were a material weakening in either the local economy or liquidity levels. Downward pressure would also result from tax-supported debt breaching 60% of consolidated operating revenues."

How a Change in Rating Affects the Interest Rate

As one might expect, there is a relationship between credit rating and borrowing costs. If, as a result of increasing debt, the City's credit rating of AA- was downgraded to A, the City would pay a marginally higher cost to borrow money.

Chart 2 gives an example of the relationship between Credit Rating and Interest Rates.

Chart 2
Credit Rating and Interest Rates

Credit Rating	Sample Interest Rate	Change in Rate	Impact over 10 Year Term
AA	3.60%	.05%	($27,750)
AA- (1)	3.65%	-	$0
A	3.75%	.10%	$55,600

Note: (1) The City's current rating.

The rating is also an example of the "confidence" suppliers or other partners would have in the City if such groups are considering contracts or agreements with a term longer than one year.

Financial Condition of the City – Report Card

Evaluating the City's financial condition involves evaluating a number of factors including:

- the state of the economy;
- service levels set by Council and legislative standards;
- composition of the community;
- the local business climate, and
- the internal finances of the municipality.

Attachment 1 to the Appendix C is a Financial Report Card for the City of Peterborough. It provides a snapshot of the City's financial health where the focus is solely on the internal finances of the Corporation. The calculations are based on the 2010 Consolidated Financial Statements of the City and are a year-over-year comparison with the 2009 reporting year.

The Financial Report Card is a tool that helps to ascertain whether or not the City is positioned to continue to pay for the services currently being provided and assess whether or not there are sufficient resources available to service the costs associated with issuing more debt and deal with financial emergencies along the way.

The report card presents a number of factors that compete with one another. For instance, approval of the new debt policy being presented in this report would impact positively on the City's Asset Consumption Ratio, however, it will negatively impact the City's Debt Interest as a Percentage of Own Source Revenues.

Although caution must always be exercised, based on the Financial Report Card, staff believes the Financial Report Card indicates the Corporation can carry a higher level of debt.

The Asset Consumption Ratio – for 2010 was 40.3%

A very telling statistic is the City's Asset Consumption Ratio listed in the Financial Report Card included in Attachment 1. This ratio shows the written down value (accumulated amortization) of the tangible capital assets relative to their historical costs. This ratio highlights the aged condition of the assets and the potential asset replacement needs. A higher ratio may indicate significant replacement needs. During 2011, the City participated in a municipal study prepared by BMA Consulting which compared 84 municipalities in the province on a variety of factors including certain financial indicators. The average Asset Consumption Ratio for the 84 municipalities was 35.4%. At 40.3%, the City's ratio is certainly higher than the 35.4% average.

The BMA Study suggests that if assets are renewed and replaced in accordance with an asset management plan, a high ratio should not be a cause for concern. Admittedly, given staff resources and budget, there is further work that could be done in the area of asset management.

Five Debt Policy Options to Consider (Pros/Cons):

The following discussion identifies five options that staff considered when developing the amended debt policy as follows:

(1) keeping with the status quo,

(2) adopting a new policy which will result in the City taking on more debt,

(3) putting a renewed emphasis on a pay-as-you-go philosophy through additional capital levy,

(4) permanently taking a certain amount of existing capital levy and redirecting an equivalent amount to debt principal and interest payments, and

(5) a combination of (2) and (3) and which is the one recommended in the new policy.

Each option is discussed below and key pros and cons are indentified for each option.

Option 1) - Status Quo – under this scenario, the current Capital Financing policy would be updated for changes to format and legislative references only. No fundamental changes would be made that would provide for additional amounts of tax-supported debt. The timing and pace of capital expenditures will continue to be limited to the amount of available funding.

Pros

- This would keep a tight lid on the amount of tax-supported debt issued given that the amount of tax-supported debt approved in any budget year is limited to the amount of tax-supported principal retired in the previous year plus any accumulated used balance from previous years.

- No change in Debt Rating and no ‘short-term’ increase in tax levy.

Cons

- The current policy is not working. Faced with the pressing need to replace existing infrastructure and provide for additional services, Council has chosen to deliberately increase tax-supported debt beyond the current policy through ‘special’ tax-supported debt issues. In 2012, ‘special’ tax-supported debt has been approved for Facility Upgrades at Morrow Park ($1.9 million) and Harper Road Landfill Remediation ($2.0 million).

- The current policy limits the City’s ability to take advantage of the attractive interest rates currently available to borrow money in the market place. Current rates are as follows:

Term – in Years	Interest Rate
10	2.70%
15	3.15%
20	3.43%
25	3.63%
30	3.74%

- The status quo means capital projects continue to be pushed out until they become almost a crisis and the infrastructure deficit continues to grow. The problem is compounded by the fact that the construction costs have been, and continue to be, increasing beyond normal inflationary rates in the 6% range.

Option 2) - Increase Debt Limits – approving a policy that would permit increased debt to be issued beyond current levels requires other financial considerations such as the ‘financial health’ of the municipality and a response to the question – how much debt can the municipality reasonably handle and how will principal and interest on new debt be paid? An analysis of the City’s ‘financial health’ is discussed in more detail in Attachment 1.

Pros

- Accelerates the pace of capital construction that otherwise will not happen in a reasonable time frame – and allowing the City to gain ground on its backlog of capital projects.

- Allows the City to take advantage of the attractive interest rates presently available in the market place.

Cons

- Increased levels of debt could substantially impact current property tax rates as debt servicing costs rise dramatically to handle the additional debt.

- If the new debt policy goes too far, the City's credit rating could decrease, marginally driving up interest rates offered to the City.

Option 3) - Additional Capital Levy – Putting a renewed emphasis on the pay-as-you-go approach.

Ideally, all rehabilitation projects should be funded from reserve funds set aside over the life of the original asset, on a pay as you go basis charged to the annual operating budget. Currently the City does not have adequate replacement reserves, and therefore, debt funding is required when replacement or major upgrades are necessary.

Each year, the annual operating budget includes a Capital Levy provision to finance capital expenditures. For 2012, this amounted to $7.4 million and included an additional provision of $486,000 to the base capital levy representing an increase of 5% over the previous year.

Pros

- Reduces amount of debt as a source of capital financing. Means capital projects cost less than if funded by debt and adding interest costs in.
- Allows more capital work to proceed.

Cons

- Does not take advantage of low interest rates currently available in the market to borrow money.
- Relying on capital levy only, means not enough funds will be available to fund all needs.
- Does not appropriately balance the payment of capital assets with long life cycles between current and future taxpayers.
- Increasing capital levy provision means increasing tax levy requirements unless Council stipulates the annual increase in capital levy must be offset by reductions in other areas of the operating budget.

Option 4) – Capitalize A Portion of Existing Capital Levy. Use a certain amount of existing Capital Levy (2012 - $7.4 million) and redirect the funds to service the principal and interest payments on new debt to be issued. This option could be exercised in conjunction with Options 2 or 5.

As an example, $2.0 million of the 7.4 million Capital Levy could be earmarked to service new debt. At a 10 year term at 2.70% interest, $17.3 million of debt could be issued.

Pros

- Provides an immediate $17.3 million source of financing for capital projects beginning in 2013.

- The impact to the tax levy would be is nil as we have just switched capital levy to debt servicing.

Cons

Council would be committing to servicing the debt obligation through redirecting $20 million of Capital Levy over the next ten years to service the resulting principal and interest costs. Total interest over the 10 year term would be $2.5 million.

Chart 3 below illustrates.

Chart 3
Amortization of $17.3 Million Created by Capitalization of $2.0M of existing Capital levy

Principal	$17,325,000
Annual Interest rate	2.700%
Term in years	10
Payment per annum	$1,978,836
Start date	January 1, 2013
End Date	January 1, 2023
Total interest	$2,462,992

Year	Period	Opening	Principle	Interest	Total Pmt	Closing
2013	1	17,325,000	1,529,902	448,935	1,978,836	15,795,098
2014	2	15,795,098	1,571,724	407,112	1,978,836	14,223,374
2015	3	14,223,374	1,614,690	364,147	1,978,836	12,608,685
2016	4	12,608,685	1,658,830	320,006	1,978,836	10,949,855
2017	5	10,949,855	1,704,177	274,660	1,978,836	9,245,678
2018	6	9,245,678	1,750,763	228,073	1,978,836	7,494,915
2019	7	7,494,915	1,798,623	180,213	1,978,836	5,696,292
2020	8	5,696,292	1,847,791	131,045	1,978,836	3,848,501
2021	9	3,848,501	1,898,304	80,532	1,978,836	1,950,197
2022	10	1,950,197	1,950,197	28,639	1,978,836	0
Total			17,325,000	2,463,362	19,788,362	

Option 5) - A Combination of Increased Debt (Option 2) and Additional Capital Levy (Option 3) – (Recommended Option)

The fifth option, and the one being recommended in this report, is a combination of Increasing Debt and increasing Capital Levy. It attempts to strike a balance between accelerating the pace of capital construction that otherwise may not be able to occur, being fiscally prudent, and limiting tax increases.

For many years, Council adopted a practice to increase base capital levy. The practice was successful and resulted in millions of dollars being added to the capital program.

Staff recommend that as a matter of practice, the annual draft operating budget include a 5% increase in the base capital levy provision as a means of providing more capital levy to support the capital budget requirements.

New Debt Management Policy – Major proposed changes

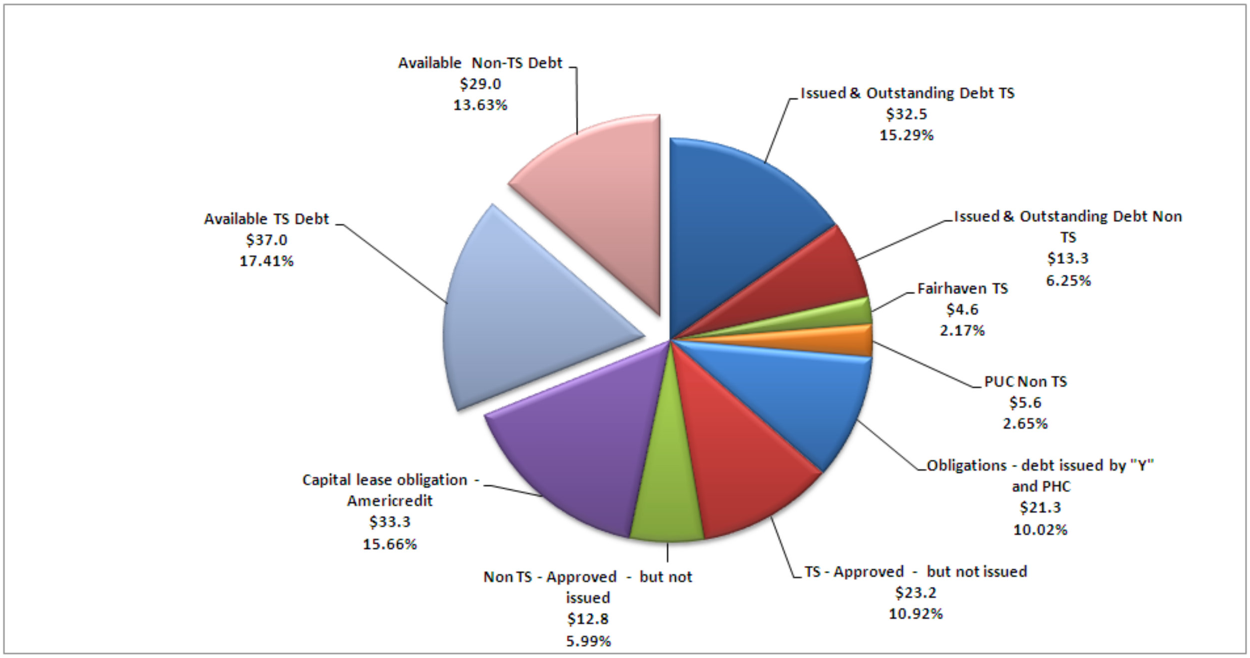
The new Debt Management Policy is attached to report CPFS12-011 as Appendix B reflects Option 5.

Key changes are summarized as follows:

- Removes 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.
- Is replaced 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:
        - Debenture financing approved through by-law but for which no debt has yet been issued
        - Debenture financing approved through the Capital Budget, but for which no by-law has yet been established
        - Outstanding financial commitments beyond the normal course of business
        - Loan guarantees
        - Significant lease obligations
        - Any debt issued by, or on behalf of, the City’s local boards including mortgages, debentures or demand loans

Graph 3 shows the various components of Debt Capacity calculation. Assuming debt issued with a term of 10 years, the new capacity created to issue tax-supported debt amounts to $37.4 million and $29.2 million for non-tax supported debt.

Graph 3
Components of Debt Capacity 2012 – $212.7 Million



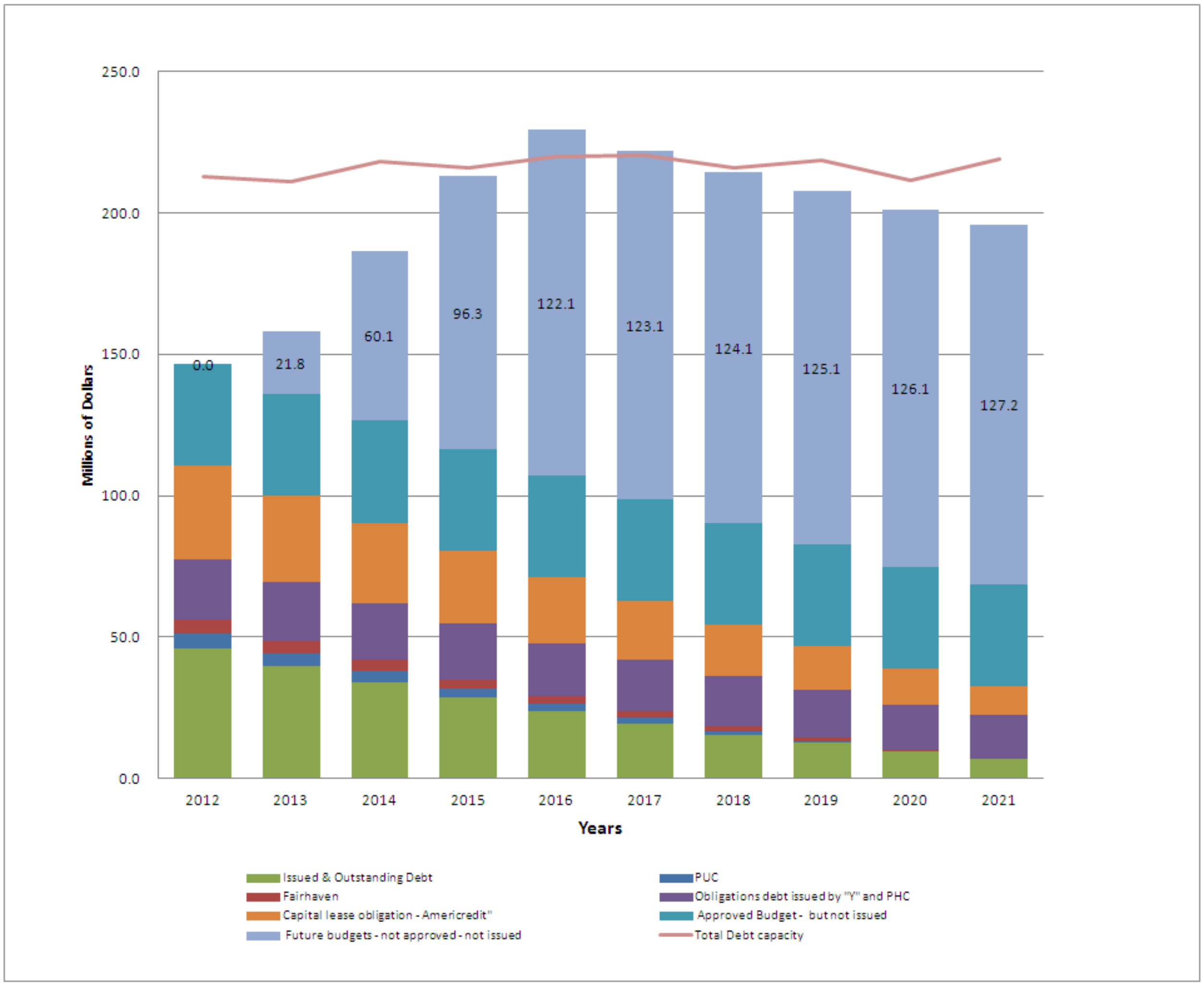
The amount of debt that could be issued within the debt capacity will depend on the term of the debt and the interest rates available in the market place. The following Chart 4 provides examples using current interest rates available:

Chart 4
Amount of Debt that could be Issued - Millions

Term In Years	Estimated Interest Rate	Tax Supported	Annual TS Debt Charges	Non Tax Supported	Annual Non TS Debt Charges	Debt Issued	Total Annual Debt Charges
10	2.70%	$37.0	$4.3	$29.0	$3.4	$66.0	$7.7
15	3.15%	$50.4	$4.3	$39.4	$3.4	$89.8	$7.7
20	3.43%	$60.9	$4.3	$47.7	$3.4	$108.6	$7.7

Graph 4 shows how the new Debt Management Policy could hypothetically accommodate new debt issues over the next 10 years assuming the projections in the 2012 Capital Budget hold true. The graph assumes any future tax supported debt was issued with a term of 10 years, and any future development charges debt was issued with a term of 20 years.

Graph 4
Total Debt and Obligations to Debt Capacity
Under New Policy



New Debt Policy - Impact on Operating Budget - Tax Supported Debt Issued

The new Debt Management Policy allow the City to issue new debt but will also increase the amount of annual principal and interest that must be repaid.

How quickly the new capacity is used, will depend on many factors, such as:

- The aggressiveness of new capital construction that requires debt financing;
- The construction inflation index;
- Length of term that the new debt is issued for;
- Interest rates in the market place, and
- Council's willingness to impact the all-inclusive tax rate to service new tax-supported debt issues.

As in the past, any new debt financing will continue to be approved by Council.

As a means of limiting how quickly the new capacity could be used, staff recommend that the impact to the all-inclusive tax rate as a result of increased principal and interest repayments on new tax-supported debentures <u>and</u> the increase in base capital levy not exceed 1% per year. For 2012, 1% equates to roughly $1.3 million. At a rate of 1% per year, increases will occur in years 1 through 4 until the new debt capacity limit is reached.

Two examples illustrate.

<u>Example 1:</u> Council chooses to increase base capital levy by $500,000 in 2013. Then $800,000 would be available in 2013 to service additional tax-supported debt. Capitalized, the $800,000 equates to approximately $6,950,000 of additional TS debt with a term of 10 years.

<u>Example 2:</u> Council chooses not to increase base capital levy in 2013. Then $1,300,000 would be available to service additional tax-supported debt. Capitalized, the $1,300,000 equates to approximately $11,300,000 of additional TS debt with a term of 10 years.

Other Related Issues

There are two key topics that, although closely related to the topic of Debt Management, have been considered outside the scope of this report. They are:

i. Storm Sewer and Sanitary Sewer Infrastructure Funding, and

ii. Capital Investment Plan and Asset Management Planning.

<u>Storm Sewer and Sanitary Sewer Infrastructure Funding</u>

At its meeting held June 14, 2010, Council in considering Report USEC10-009 entitled “Flood Reduction Master Plan Progress Report and Watershed EA Capital Projects” adopted the following recommendations:

> *a) That staff be requested to include a funding level of $2.5 million for implementation of the Watershed EA Capital Projects in the 2011 Budget estimates for discussion purposes; and*
>
> *b) That staff be requested to report further to Council on possible funding arrangements that incorporate Recommendation a) and the other storm water/sewer funding requirements as detailed in Report USEC10-009.*

The “other” storm water/sewer funding requirements that were referenced in Report USEC10-009 in Recommendation b) included:

- Capital projects related to the storm water sewer system;
- General operating maintenance of the storm water sewer system;
- Capital projects related to watercourses within the City;
- General operating maintenance of the watercourses within the City; and
- Analysis of Citywide storm water quality.

The forthcoming report will recommend an appropriate funding level to maintain, rehabilitate and replace our existing storm and sanitary infrastructure (including the Flood Reduction Watershed EA Capital Projects) considering the sustainability of the systems and accounting for existing and potential legislation requirements. A comparison with existing funding levels will provide guidance on the magnitude of the funding gap that needs to be bridged and some funding scenarios will be explored.

The topic is related to Debt Management in that currently, unlike the Sanitary Sewer Surcharge funds, expenditures for Storm Water management do not currently have a dedicated funding mechanism. A dedicated funding mechanism would lessen the need for debt financing storm sewer projects.

Capital Investment Plan and Asset Management Planning

To continue to be eligible to receive Federal Gas Tax Funding, all municipalities must show progress toward development of a Capital Investment Plan (CIP) and an Integrated Community Sustainability Plan (ICSP). The City has formally allocated resources to respond to the requirement for an ICSP. Report CSD12-002 Presentation of the draft Sustainable Peterborough Plan dated February 13, 2012 noted that the final plan will appear before Council on March 26, 2012. However, there are no dedicated resources allocated to develop a CIP.

Under the Gas Tax Agreement, municipalities must meet three Capital Investment Plan Requirements: they must be Public Sector Accounting Board (PSAB) compliant, show progress toward developing a multi-year Capital Budget based on lifecycle costing and show progress toward developing a full Asset Management Plan that integrates both operating and capital costs.

PSAB Compliance - Under both provincial regulation and the Gas Tax Fund Agreement, municipalities were required to be compliant with PSAB standards. The City achieved compliance on January 1, 2009.

Long-Term Capital Budgeting – while the City has a well established process for long-term capital budgeting, not all budget requests are based on a lifecycle costing analysis. To date, the City has adopted a ‘phased-in’ approach as time and financial and staff resources permit. For instance, lifecycle costing has been adapted for capital expenditures for Buildings, Transit buses, and, to a lesser extent Public Works fleet vehicles. Despite this, staff acknowledges that this work is essential to improving asset management and financial sustainability over the long-term. To do so adequately requires dedicated staff resources.

Asset Management Planning - The final requirement is a full Asset Management (AM) Plan that includes lifecycle costing, which takes into account both operating and capital expenses. Of the municipalities that have reported to AMO in 2010, 51 per cent indicated they have a full Asset Management Plan. The implementation of the tangible capital asset components of PSAB was expected to increase the number of municipalities with full Asset Management Plans. As such, many municipalities, large and small, rural and urban, are taking the next logical step and developing comprehensive long-term integrated capital plans for all of their service producing assets.

The key questions that any AM plan seeks to answer are:

1. What do we have?
2. What is it worth?
3. What condition is it in?
4. What do we need to do to it?

5. When do we need to do it?
6. How much money do we need?
7. How do we reach sustainable funding?

Only limited work has been done on AM Planning at the City of Peterborough (eg. Facilities), more from an ad hoc approach. Question one was answered through the PSAB compliance step. Question two was answered, but was based on historical cost, whereas proper AM planning requires analysis based on future replacement costs. Depending on the particular asset (or group of assets), bits and pieces of answers are known for questions three through seven. The key barriers that impede progress are human resources and budget.

The Drummond report released in February 2012 made several recommendations related to municipal infrastructure management and funding. These are: better use of detailed long term asset management practices in broader public sector organizations to better manage assets; a strategic asset management plan targeted at the municipal sector that looks at funding options, and private sector involvement. The report also asks whether stable and predictable funding from the Province for infrastructure will contribute to more effective and efficient infrastructure management. The Commission also commented positively on the use of alternative financing and procurement methods and recommends full cost recovery for municipal water and wastewater services be implemented.

Invariably, any AM plan will involve debt financing, but instead of a reactive measure, the planning process becomes much more proactive in terms of answering the ‘how much’ and ‘when’ questions, allowing a much larger window of time to ensure other sources of funding are available, in theory, mitigating the need for debt financing.

While the City does not have a full CIP or AM plan, even for the costs that are known, there is need to increase the amount that can be spent on capital.

Staff recommend a further report to Council with recommendations on how to develop a CIP and AM program.

Attachment 1 – Financial Report Card

Appendix C - Attachment 1
Financial Report Card
Based on Consolidated Financial Statements

Ref	Financial Indicator	2010	Change from 2009 to 2010	2010	2009	2011 BMA Study Average
1	Financial position per capita	🟢	+	$ 1,155	$ 1,068	$ 185
2	Operating surplus ratio	🟢	+	9.40%	8.70%	-5.70%
3	Taxes Receivable as % of taxes levied	🟢	−	3.50%	3.20%	5.60%
4	Net financial assets	🟢	+	$ 90,249,000	$ 89,679,000	n/a
5	Net financial asset as % of own source revenues	🟢	+	52.90%	50.60%	28.00%
6	Debt to total reserve ratio	🟡	−	0.90	0.60	1.50
7	Debt outstanding per 100,000 unweighted assessment	🟡	−	$ 1,270	$ 829	$ 565
8	Debt interest as a % of own source of revenues (excludes Water/Sewer)	🟡	−	2.40%	2.10%	1.60%
10	Discretionary reserves as % of own source of revenue	🟡	−	43.10%	46.90%	45.00%
11	Asset consumption ratio	🟡	+	40.30%	40.40%	35.40%

Legend

- **Positive:** stay the course 🟢
- **Caution:** in the right range but may be moving in the wrong direction 🟡
- **Negative:** take corrective action 🔴
- **Positive change** - from 2009 - 2010
- **Negative change** - from 2009 - 2010 −

Financial position: This term refers to the remaining assets in excess of all liabilities. Positive balances indicate the City's margin of safety it possesses to cover debt obligations and to have funds set aside for future sustainability. Year over year, the City has improved this ratio from 2009 and continued focus on increasing assets while lowering liabilities will keep this indicator on a positive trend.

Operating surplus ratio: This ratio provides perspective on how much of the City's own source of revenue were left after normal operations that could be used to fund reserves, pay down debt and invest in capital projects. The trend from 2009 was positive with the City having more surplus available in 2010 for these financing and capital activities.

Receivables as % of taxes levied: Uncollected property taxes as a percentage of total taxes charged is an indication of the strength of the local economy and the ability of the community to pay their annual tax billings. The City enjoys a low ratio showing good economic health and strong internal controls over tax collection.

Net financial assets: The amount is an indicator of the City's ability to repay liabilities at a point in time and is a useful trending tool. The upward trending in 2010 indicates that the City retained financial assets during the year. Movement of this amount depends on the balance of financial assets compared to liabilities; equity in the COPHI group of companies, cash and investment holdings play a significant role in this number.

Net financial asset as % of own revenues: Similar to the ratio as described above, this indicator is annualized by comparing the net financial asset position to the current revenue and provides an additional level of understanding useful for trending analysis and financial monitoring.

Debt to total reserve ratio: This indicator provides a measure for financial prudence by comparing total debt to the total reserve balances. Generally, the benchmark suggested for this ratio is 1:1 or in other words, debt should not exceed total reserve and reserve fund balances. At the end of 2010, after debenturing for a number of projects, including the Airport, the City exceeded the standard and is a good indicator for long-term sustainability and the ability to meet its debt obligations.

Debt outstanding per weighted assessment: This shows total debt compared to the value of the tax assessment base and provides a fair basis to compare the City's debt to other municipalities. Including all local boards, there was $40.3 million of long term debt incurred in 2010, it would be expected that this rate has declined (ie. dollar value has risen) and would be considered higher than average when compared to other municipalities.

Debt interest as a % of own source revenues: This ratio indicates the extent to which the City's own source revenues are committed to debt charges and again is a useful tool when comparing to other municipalities. Debt interest charges at 2.4% of own source of revenues would be considered above average when compared to other municipalities.

Discretionary reserves as % of own source of revenue: Reserves offer liquidity which enhance the municipality's flexibility in addressing operating requirements and in permitting the municipality to temporarily fund capital projects internally, allowing it time to access debt markets and take advantage of favourable conditions. An average municipal percentage would be approximately 45%.

Asset consumption ratio: This ratio shows the written down value of the tangible capital assets relative to their historical costs. This ratio seeks to highlight the aged condition of the assets and the potential asset replacement needs. A higher ratio may indicate significant replacement needs. At 40.3%, the ratio would be considered higher than average. However, if assets are renewed and replaced in accordance with an asset management plan a high ratio should not be a cause for concern.