Schedule “A” to By-Law XX-2022

Policy Type: Finance Department

Subsection:

Policy Title: Debt Management Policy

Policy Number:

Policy Approved By:

Effective Date:

Reviewed:

Revised:

Applicable To: Members of County Council and Staff

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Policy Statement

The Debt Management Policy provides guidance to Northumberland County Council (Council) and staff regarding the issuance of debt and management of the debt portfolio, as well as identifying alternative possible funding sources for capital. A Debt Management Policy is beneficial as it assists in consistent decision-making, rationalizes the decision-making process, identifies objectives for staff to implement, and demonstrates a commitment to the objective of long-term financial planning.

The policy should achieve a balance between establishing limits on the debt program and providing sufficient flexibility in response to unforeseen circumstances and new opportunities to preserve and improve the long-term financial health of Northumberland County (the County).

Purpose

The policy provides a framework for debt management. The policy contains written objectives, guidelines, practices, procedures, and restrictions for the issuance and management of debt and financial agreements.

Definitions

Act: The Municipal Act, 2001, S.O. 2001 c.25, as amended.

Annual Repayment Limit (ARL): Under Act, c. 25, Regulation 403/02: Debt and Financial Obligation Limits, this limit represents the maximum amount which a municipality has available to commit to payments relating to debt and financial obligations without seeking the approval of the Ontario Land Tribunal. This limit is provided annually to a municipality by the Ministry of Municipal Affairs and Housing. Additionally, this limit must be updated by the County Treasurer prior to Council authorizing any increase in debt financing for capital expenditures.

Authorized Debt: Council approved debt financing as a source of funding for capital projects.

Capital Financing: A generic term for the financing of capital assets. This can be achieved through a variety of sources such as tax levy, grants, reserve or reserve funds, development charges and debt.

Capital Plan: The budget for capital projects (i.e., the expenditures and resources required for capital projects).

Credit Rating: A rating assigned by a credit rating agency as to the credit worthiness of an entity's debt obligations.

Debt: Any obligation for the payment of money including internal borrowing.

Debenture: A formal written obligation to pay specific sums on certain dates. In the case of a municipality, debentures are typically unsecured (i.e., backed by general credit rather than by specified assets).

Debt Management Policy (Policy): Refers to this document.

Debt Program: Refers to the practices related to authorizing debt, issuing debt and monitoring debt. For example, part of the debt program includes issuing debt and the particulars related to issuing debt specifically the amount, timing and structure of the issuance.

Debt Servicing Costs: Debt repayments inclusive of principal and interest.

Development Charges Revenue: Development charges collected from new development, to help fund the cost of infrastructure required to accommodate growth as identified in a Development Charges Background Study.

Development Charges Funded Debt: Debt issued for Council-approved growth-related infrastructure, identified in the Development Charge Background Study, to be repaid exclusively with Development Charge collections.

Internal Borrowing: Financing provided from a County reserve or reserve fund to finance projects with terms for repayment over a period of time exceeding a year.

Internal Debt Financing Cap: The County's internal limit on debt as a source of capital financing for capital projects.. This limit is not referring to limits imposed by the Act or regulations thereunder such as the ARL

Issued Debt: A fixed obligation, such as a debenture, notes or other agreements between the issuer (the borrower) and the lender. Municipalities issue debt to finance a variety of projects such as infrastructure projects.

Lease Financing Agreement: A financial lease agreement for the purposes of obtaining long term financing of a capital undertaking of the County. For example, leasing of a fleet vehicle.

Own Source Revenues – amounts collected by the County that include property taxes and other types of income but exclude:

- Ontario and Canada Grants, including grants for tangible capital assets
- Deferred revenue earned (Provincial and Canada Gas Tax)
- Deferred revenue earned (Development Charges)
- Other Deferred revenue earned
- Revenue from other municipalities, including revenue for tangible capital assets
- Gain/Loss on sale of land and capital assets
- Donated tangible capital assets
- Contributions or net transfers from a reserve or reserve fund
- Increase/Decrease in government business enterprise equity

Treasurer: The individual appointed by the County as Treasurer who has overall responsibility for the management of the County's financial affairs and provides critical financial leadership to Council and the Corporation to ensure long-term financial sustainability.

Authority

As allowed under section 401 of the Act, the Treasurer shall have the authority and responsibility to recommend to Council the most effective form of debt financing for any work/asset, in addition to the appropriate timing and duration.

Under section 403/02 of the Act, annual debt and financial obligation limits for municipalities are defined. This regulation provides the authority and imposes restrictions regarding a municipality's ability to issue debt such that the annual principal and interest payments cannot exceed 25% of own source revenues.

Scope

This policy applies to the issuance of all debt and resulting repayment terms, including capital lease financing arrangements, and any other financial obligations entered into by the County. The policy applies to all County of Northumberland departments.

Objectives

The primary objectives of this policy are as follows:

1) Adherence to statutory requirements
2) Ensure long-term financial flexibility and sustainability
3) Establish parameters regarding the purpose for which debt may be issued along with the timing, types and terms of permissible debt
4) Limit financial risk exposure and minimize long-term costs of financing

Adherence to Statutory Requirements

Capital financing utilizing debt may only be undertaken if and when it is in compliance with the relevant sections of the Act. If there are any discrepancies between this policy and the applicable legislation, the legislation will always take precedence. Requirements under the Act include but are not limited to the following:

- The term of temporary or short-term borrowing for operating purposes will not exceed the current fiscal year.
- The term of the capital financing will not exceed the lessor of 40 years or the useful life of the underlying asset.
- Long-term debt (borrowing) will only be issued for capital projects.

Ensure Long-Term Financial Flexibility and Sustainability

The County's ability to respond to unanticipated and emerging financing needs is affected by its access to funding, its debt capacity and debt service charges. Financial sustainability depends on the debt levels and debt service charges being consistent with the County's level of affordability, both current and future. Debt issuance decisions must align with ensuring long-term financial flexibility and sustainability for the County. Goals and limits on debt, and financial measures to assist in assessing financial flexibility and sustainability are as follows:

- To the extent possible, for any regular and/or ongoing capital expenditures, the current portion of future rehabilitation, and replacement costs will be recovered on a "pay as you go" basis through tax levy, user fees and/or reserve and reserve fund monies.
- The County will seek to maximize the use of grants and subsidies from senior levels of government, as well as any other possible sources of external capital funding.
- Where long-term financing is required, due consideration will be paid to all forms of financing.
- Adequate reserves must be developed and maintained for all capital assets owned by the County to ensure long-term financial flexibility as prescribed in the Reserves and Reserve Funds Policy.
- Internal borrowing may be considered as a means of financing capital projects where adequate funding from reserve or reserve funds exists.
- Staff and Council shall review future asset needs as identified within the Asset Management Plan(s) and impacts to debt capacity and debt servicing costs over the long-term.

Establish Parameters Regarding the Purpose, Timing, Types and Terms of Permissible Debt

The County may acquire debt by temporary borrowing, debenture, mortgage or other acceptable debt instruments and financing agreements that support corporate priorities and the approved strategic plan, while using the following guidelines to determine on a case-by-case basis whether the use of debt is appropriate:

- Long-term debt will only be used for capital expenditures incurred to acquire, develop, renovate or replace capital assets used in the delivery of municipal services.
- Long-term debt will not be used to finance current operations. The County may use long-term debt to fund the acquisition or major rehabilitation of existing infrastructure in circumstances where funding cannot be accommodated within the tax-supported budget.

- Long-term debt will be structured in a way that is fair and equitable to those who pay for and benefit from the underlying assets over time.
- The timing, type and term of debt will be determined with a view to minimizing long-term cost considering capital market conditions and the nature of the project.
- The term of debt will be limited to the lesser of the term of the useful life of the particular asset and 40 years.
- The County shall not issue long-term financing on projects/capital works until they are substantially complete, or a significant milestone is achieved.
- Temporary financing instruments may be issued either for operating or capital purposes. Temporary financing for amounts that the County considers necessary to meet the expenses during the current fiscal year until the receipt of taxes and other revenues shall be in accordance with Section 407 of the Act and the temporary borrowing by-law passed by Council.
- Temporary borrowing as per section 405 of the Act is permitted to be used to meet cash flow requirements during the construction of capital infrastructure. Temporary borrowing will be no greater than 5 years and long-term debt will be secured as soon as possible after the completion of a project or 5 years, whichever is less, to replace the short-term borrowing. All temporary borrowing costs will be charged as part of the project costs and form part of the long-term debt requirements.
- Internal borrowing may be utilized for capital projects where adequate funding from reserve or reserve funds exists. Interest rates for borrowing internally from reserve funds will be set by utilizing a rate calculated as prescribed in the Reserves and Reserve Funds Policy.
- Lease financing agreements may be issued for capital purposes. Prior to entering into a lease financing agreement, an analysis will be prepared that assesses the costs as well as the financial and other risks associated with the proposed lease with other methods of financing.

Limit Financial Risk Exposure and Minimize Long-term Costs of Financing

Debt will be managed in a manner to limit, where practicable, exposure to interest rate risk, foreign currency risk, financial risk associated with entering into financial leases, and any other financial risks which may arise from the debt financing. The type, term and structure of financing instrument used to issue debt and the timing for debt issuance will be determined to minimize the overall long-term cost of financing. Factors to consider include the following:

- The County's general practice shall be to issue debt that is denominated in Canadian dollars with fixed interest rates over the term. Notwithstanding, if a borrowing structure is presented for which there is a material financial advantage and/or it is deemed prudent for the County to issue debt that is subject to interest rate fluctuations, the

County may, at the discretion of the Treasurer, consider entering into this type of arrangement. Variable interest rate structures must be in accordance with Ontario Regulation 247/01.

- Prior to passing a debenture by-law which provides that installments of principal or interest, or both, are not payable during the period of construction of an undertaking, Council will have considered all financial and other risks related to the proposed construction financing.
- The County shall have a term preference of 10 years for debentures or other types of long-term financing for capital works. The term of long-term financing shall not extend beyond the lifetime of the capital work for which the debt was incurred and shall not exceed 40 years in accordance with Section 408 (3) of the Act. The term preference as well as structure of long-term financing instruments will be at the discretion of the County Treasurer and subject to the requirements of the Act and Council approval.
- The County shall monitor debt servicing costs and annual repayment limits as prescribed under Ontario Regulation 403/02: Debt and Financial Obligation Limits. The County shall also utilize other benchmarks, measures, indicators, ratios and limits as determined relevant and appropriate by the Treasurer to monitor debt levels and servicing costs. These measures shall include, but are not limited to, debt servicing costs as a percentage of gross operating expenditures, debt financing as a percentage of the capital budget, debt per household and debt servicing costs as a percentage of revenue.
- The County shall strive to secure a strong credit rating to assist in securing a favourable cost of borrowing as may be required.

Procedures

The core procedures outlined within this policy are as follows:

1. Adherence to the Internal Debt Financing Cap
2. Ensuring Debt Capacity for Future Priority Projects
3. Allocation of Tax Room from Retired Debt
4. Reporting
5. Policy Review

Any internal standard operating procedures and/or practices will comply with the core procedures as stated in this policy.

Adherence to the Internal Debt Financing Cap

The County’s Internal Debt Financing Cap for annual debt repayment costs, including any internal borrowing, will not exceed 12.5% of own source revenues. This will provide a minimum of 12.5% in flexibility in respect to the prescribed ARL under the Act of 25%, if required, to respond to emergencies, peak period of asset management pressures, and/or to meet government funding opportunities. At any point in time, if County Council decides to surpass the Internal Debt Financing Cap of 12.5% of the County's own source revenues as set out in this policy, a resolution shall be passed which waives the policy restriction to surpass the 12.5% limit.

For purposes of calculating the Internal Debt Financing Cap, debt servicing costs will be reduced to the extent grants from upper levels of government can reasonably be attributed by the Treasurer as capital grants received on a recurring basis post project completion that would otherwise have reduced the amount of debt acquired had the grant funds been made available by project completion.

Annual debt financing costs for any Development Charges funded debt will be further subject to a limit equal to 25% of the 10-year budget forecast of average annual Development Charges revenues.

To monitor and control the impact of the debt repayment costs on the approved annual budget of any given year, and in consideration of the impact on future taxpayers, the annual approved capital budget will demonstrate a balanced approach amongst all forms of funding, including debt, over a 10-year horizon.

Under no circumstances will the payments for the County's indebtedness exceed the ARL as set annually by the Ministry of Municipal Affairs and Housing.

Council must authorize long-term debt through by-law. Before doing so, Council is required to obtain the Treasurer's certification that the municipality has sufficient capacity within its ARL to incur additional debt.

Ensuring Debt Capacity for Future Priority Projects

The County could face the risk in any fiscal year of having insufficient debt capacity to fully execute its capital plan, based on its annual debt repayment policy limit. To manage this risk, the capital plan will show the amount of debt financing that will be required for each project and each year of the plan. Each project will be prioritized by the Treasurer along with Senior Leadership during the annual budgetary process based on its impact on the County's Long-Term Financial Plan and/or the Strategic Plan as approved by Council.

Allocation of Tax Room from Retired Debt

Tax room created from elimination of the annual principal and interest payments on retired debt shall be considered for allocation by Council as part of the annual budget as follows:

- To offset any new debt servicing costs commencing in the year of the debt retirement.
- To reserves for infrastructure projects as an additional funding source for the renewal, rehabilitation and/or replacement of aging infrastructure.

Reporting

In addition to any information requested by Council, or any information that the Treasurer considers appropriate, the following shall be reported to Council;

- The status of issued and authorized debt as well as debt servicing costs through the annual budget process;
- Projections for debt levels and debt servicing costs through the long-term plan; and
- Debenture issuances.

Policy Review

The policy will be reviewed periodically by the Treasurer. Any required changes shall then be submitted to Council for consideration and approval. Any changes or revisions to the Act or the regulations thereunder subsequent to the formal adoption of the policy which affect the policy will apply when they come into force. The policy will be updated to reflect such change(s) at the time of formal review.