



The Regional Municipality of York

## **Long-Term Debt Management Plan**

Includes Capital Financing and Debt Policy

# 2014 Long-Term Debt Management Plan

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# 2014 Long-Term Debt Management Plan\*

## Introduction

Municipalities in Ontario may only issue debt for capital purposes. The Province regulates the amount of municipal debt and other financial obligations through an Annual Repayment Limit (ARL) regulation under the *Municipal Act*. The ARL limits the aggregate annual cost of servicing the anticipated long-term debt and financial obligations to 25% of a municipality's own source revenue plus, in the case of York Region alone, a growth cost supplement equal to 80% of the average of the Region's last three fiscal years of development charge collections. The combination of the ARL and the growth cost supplement is called the Growth-Related ARL, but will be referred to as the ARL in this plan.

To qualify for the growth-related cost supplement, the Region is required to meet two conditions:

1. Maintain at least an AA low (or equivalent) credit rating; and
2. As part of the preparation of its budget for the fiscal year, Council adopts or affirms a plan for the management of its long-term debt and financial obligations.

As of November 2013, the Region had met the first condition by maintaining a AAA credit rating with both Moody's Investor Service and Standard and Poor's Rating Services for the thirteenth and twelfth year in a row respectively.

To meet the second condition, the Province requires Regional Council to consider the following items as part of its long-term debt management plan:

1. The Region's needs for its long-term debt and financial obligations over a multi-year period
2. Projections of the ARL for each year of the multi-year period compared to its existing and proposed long-term debt-related payments
3. Risk and mitigation strategies associated with the Region's long-term debt strategy
4. Long-term debt and financial obligations policy
5. Prudent and cost-effective management of existing and projected long-term debt and other financial obligations
6. Estimated temporary borrowing needs for 2014
7. Evaluation and comparison of 2013 projections and outcomes.

\* The 2014 Long-Term Debt Management Plan was approved by York Regional Council December 19, 2013 as Attachment 2 of the Regional Fiscal Strategy

# **1. The Region's Needs for its Long-Term Debt and Financial Obligations Over a Multi-Year Period**

## **The Region's reliance on debt to finance its capital plan has decreased significantly**

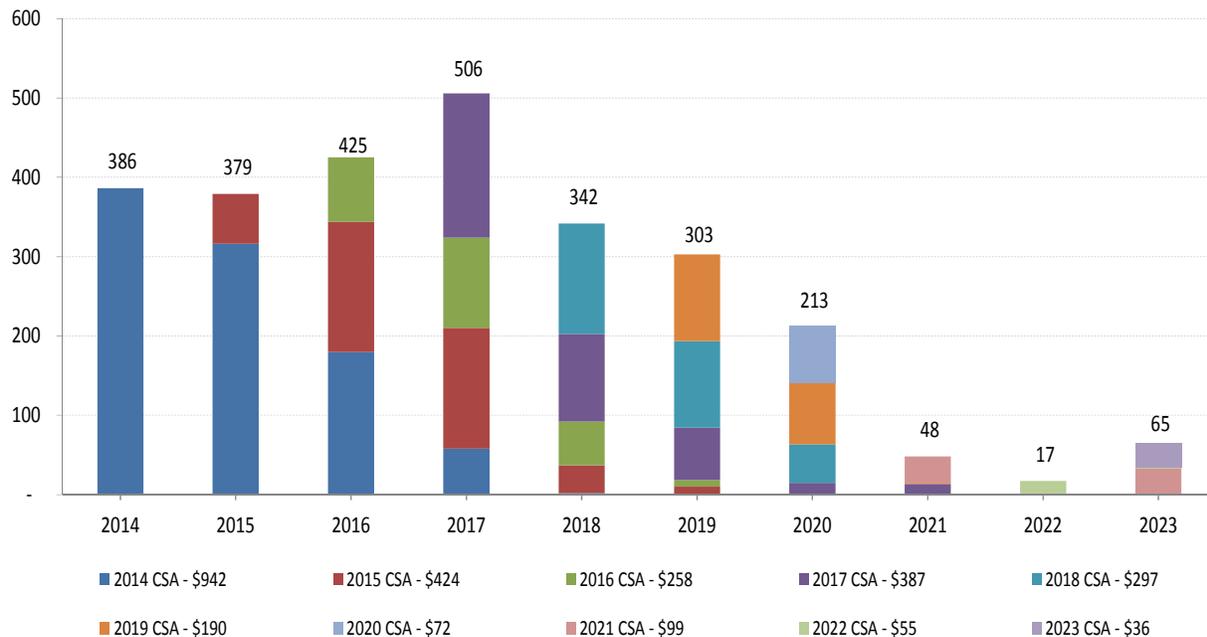
As part of the 2014 budget process, staff has developed a fiscal strategy to help guide the funding of the Region's capital plan. A major objective of this strategy is to develop a more balanced approach to funding long-term capital expenditures. To accomplish this, a detailed review of both expenditures and funding sources was undertaken by departmental staff across the Region. Through the review, it was determined that certain capital expenditures could be deferred into later periods without negatively affecting the Region's ability to maintain service levels. Doing so relieved major development-charge-related funding pressures, allowing for more flexibility in the use of DC reserve funds. In addition, the fiscal strategy aimed to reduce tax-levy related debt through a debt reduction plan that used cash funds in reserves to replace tax levy debt financing. As a result of these fiscal measures, anticipated debt needs have been significantly reduced from previous forecasts.

The 2014 Capital Plan shows capital expenditure needs totaling approximately \$6.6 billion over the 2014-2023 forecast period. Of this, approximately \$2.7 billion or 40 per cent will be funded from debenture proceeds. This compares to a debt funding ratio of over 65 per cent anticipated for the same period in the 2013 capital plan. Approximately \$0.9 billion of the \$2.7 billion in projected debenture requirements is included within the Capital Spending Authority (CSA) for 2014, as illustrated in Chart 1.

Capital Spending Authority provides Council's authorization for departments to proceed with capital projects, including multi-year projects. The Region must have enough debt room when Capital Spending Authority is approved to remain within its provincially-mandated Annual Repayment Limit.

The Region's capital plan also contains projects with an estimated debt of about \$1.8 billion that are planned, but do not yet have Capital Spending Authority. For the purposes of this Debt Management Plan, departments have estimated the Region's future debt requirements for each year of the plan on a CSA basis. This will be described in further detail below.

**Chart 1**  
**Multi-Year Forecast of New Debt to be Issued - \$2.7 Billion**  
**Based on CSA Forecast by Year**  
**2014-2023**  
**(\$Millions)**



Source: York Region Finance Department

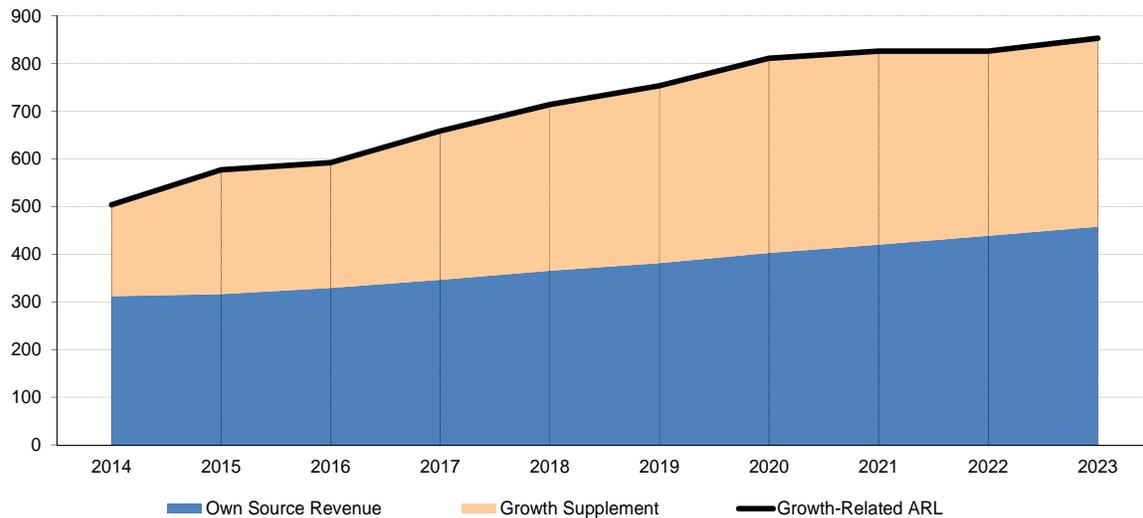
## 2. Projections of the ARL for Each Year of the Multi-Year Period Compared to Existing and Proposed Long-Term Debt-Related Payments

### How much debt room are we estimating we will have?

The ARL is calculated by determining and projecting 25% of the Region’s own-source revenues, and adding 80% of the three-year rolling average of historic development charge collections. The Region’s existing and proposed annual financial obligations must be within this limit. These calculations are shown in Appendix 1.

Based on these calculations, the Region’s ARL increases from \$504 million in 2014 to \$854 million by 2023, as illustrated in Chart 2 below:

**Chart 2**  
**Annual Repayment Limit Forecast**  
**2014-2023**  
**(\$Millions)**



Source: York Region Finance Department

**What are our estimated debt and financial obligation payments?**

The existing debt payment and financial obligations include the following components:

- Principal Obligations
- Interest Obligations
- Social Housing Mortgages
- Long-term Leases
- Hospital Funding.

These existing obligations totaled approximately \$295 million at the end of 2013, but are estimated to decline to \$185 million by 2023. The largest component of these obligations is the principal and interest on existing debt, which will decrease from \$266 million in 2013 to \$155 million by 2023 as existing debt is repaid. Hospital financing is forecast to increase at a rate of 2% per year, rising from \$12.7 million in 2014 to \$15.2 million by 2023.

As noted earlier, the CSA budgeting concept employed by the Region requires that there be enough debt room under the ARL at the time of project authorization. For example, in order to assign CSA to projects as part of the 2014 budget process, the Region must have sufficient room under its 2014 ARL to recognize the full financial cost of the projects “as if” they were going to be incurred entirely in 2014, even if the actual costs are spread out over multiple years. This is the case for each year of the capital plan.

The Capital Spending Authority in the 2014 Budget is \$2.6 billion, of which \$0.9 billion is debt financed. Assuming an annual interest rate of 5.11% in 2014 and a term of 20 years, the annual obligation arising from this debt will be approximately \$75 million.<sup>1</sup>

**Will the Region be within its ARL?**

For 2014, the Region will be within its ARL, as shown in Table 1 below.

**Table 1**  
**Region’s 2014 ARL Calculation**  
**(\$Millions)**

Component Description	Forecast 2014
25% of Own Source Revenues	312
<b>Plus:</b> Growth Cost Supplement <sup>1</sup>	192
<b>Total ARL</b>	<b>504</b>
<b>Less:</b> Existing Debt Payment and Financial Obligations	321
<b>Less:</b> Anticipated New Debt Payment	75
<b>Remaining ARL (&gt;\$0)</b>	<b>108</b>

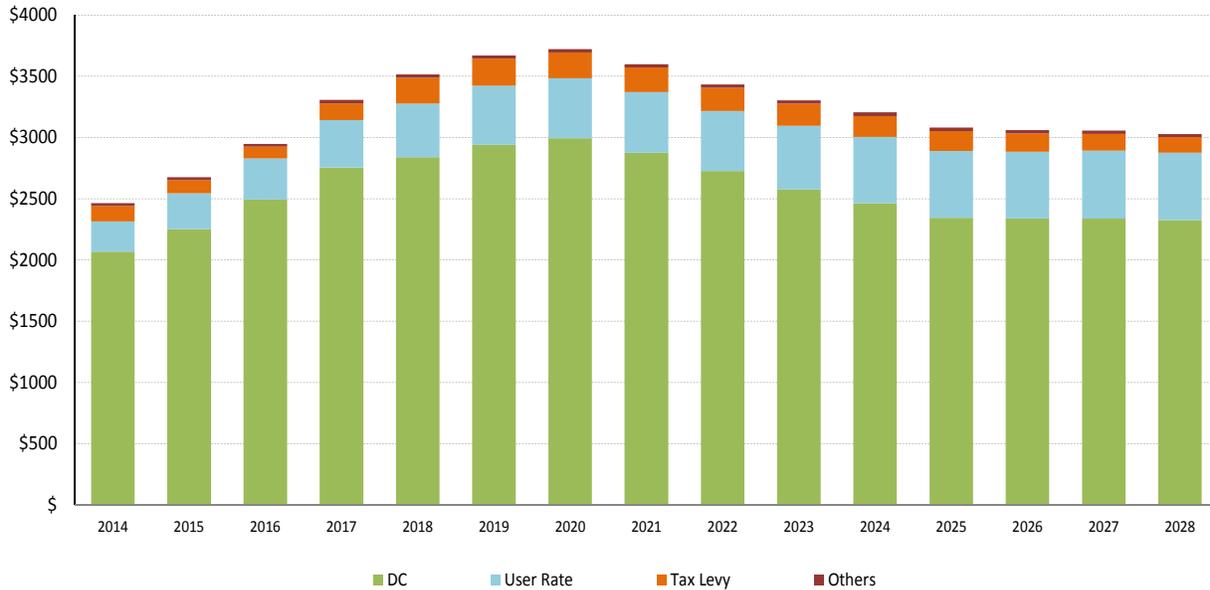
<sup>1</sup> Growth Cost Supplement in 2014 is calculated at 80% of the 3-year rolling average of Development Charge collections (2011-2013 inclusive)

To replicate this calculation over a multi-year period, future CSA has been estimated based on the anticipated timing of future project commitments. While debt authorities will not be carried forward from one year to the next, it is assumed that the amount of debt authorized in 2014 will form the “base” for the debt request to be authorized in subsequent years. Assuming that the debt needs remain as shown in the ten-year capital budget and all future CSA debt occurs as planned, the Region’s outstanding debt will increase from \$2.5 billion in 2014 to a high of just over \$3.7 billion in 2020 and then start to decrease in 2021, as illustrated in Chart 3.

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<sup>1</sup> Weighted average interest rate based on a review of current and historic rates as well as planned CSA cash flow timing. The 20-year term is based on the anticipated average term of future debt issues. Debt repayment is calculated on a “Full Commitment Basis”, which allocates a full year’s payment to the year of issuance rather than the partial (i.e., interest only) payment that usually occurs as a result of issuance timing.

**Chart 3**  
**Outstanding Debt Projection**  
**2014 to 2028**  
**(\$Millions)**



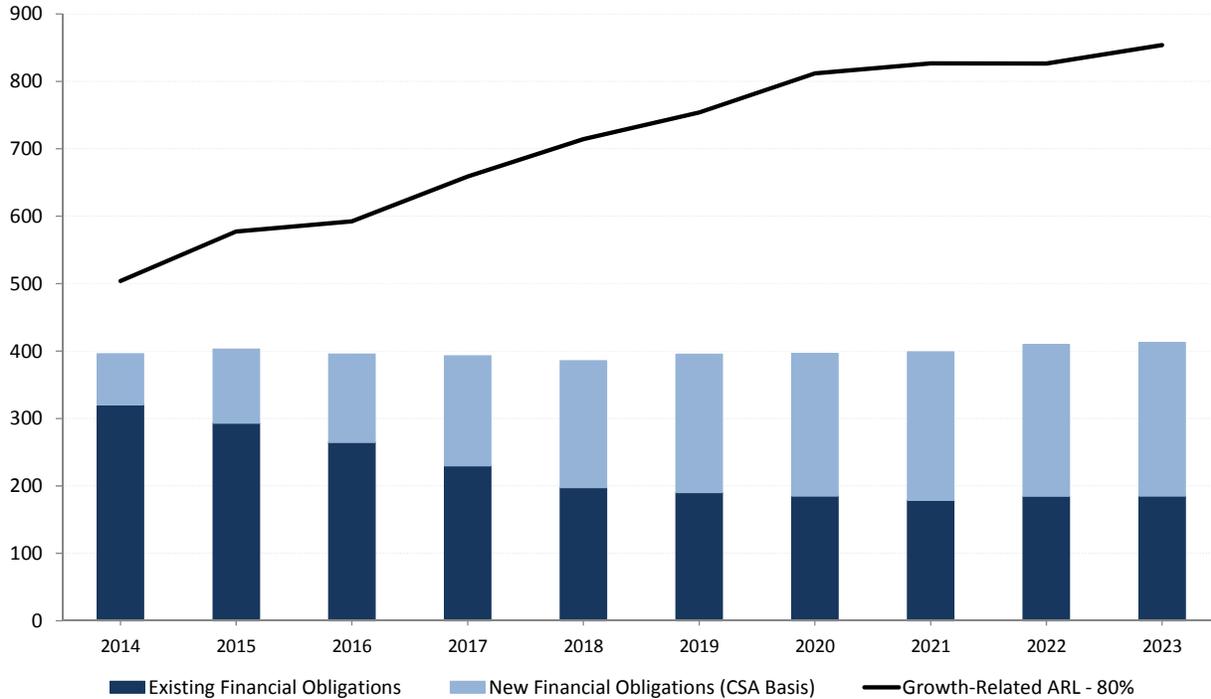
Source: York Region Finance Department

The annual debt payments related to each year’s increment have been calculated on the same basis as the 2014 CSA, except that the assumed interest rate will increase to 6.25% by 2021.<sup>2</sup> As a result, the financial obligations associated with new debt-related CSA will increase to \$223 million by 2023.

Chart 4 shows that the Region’s financial obligations are well within its ARL for all years.

<sup>2</sup> The base rate assumptions increase from 5.0% to 6.50% by 2024 and are held constant thereafter. The term will remain 20 years and the payment will continue to be calculated on a “Full Commitment” basis for the entire forecast.

**Chart 4**  
**Annual Repayment Limit vs.**  
**Annual CSA Based Debt and Financial Obligations**  
**2014-2023**  
**(\$Millions)**



Source: York Region Finance Department

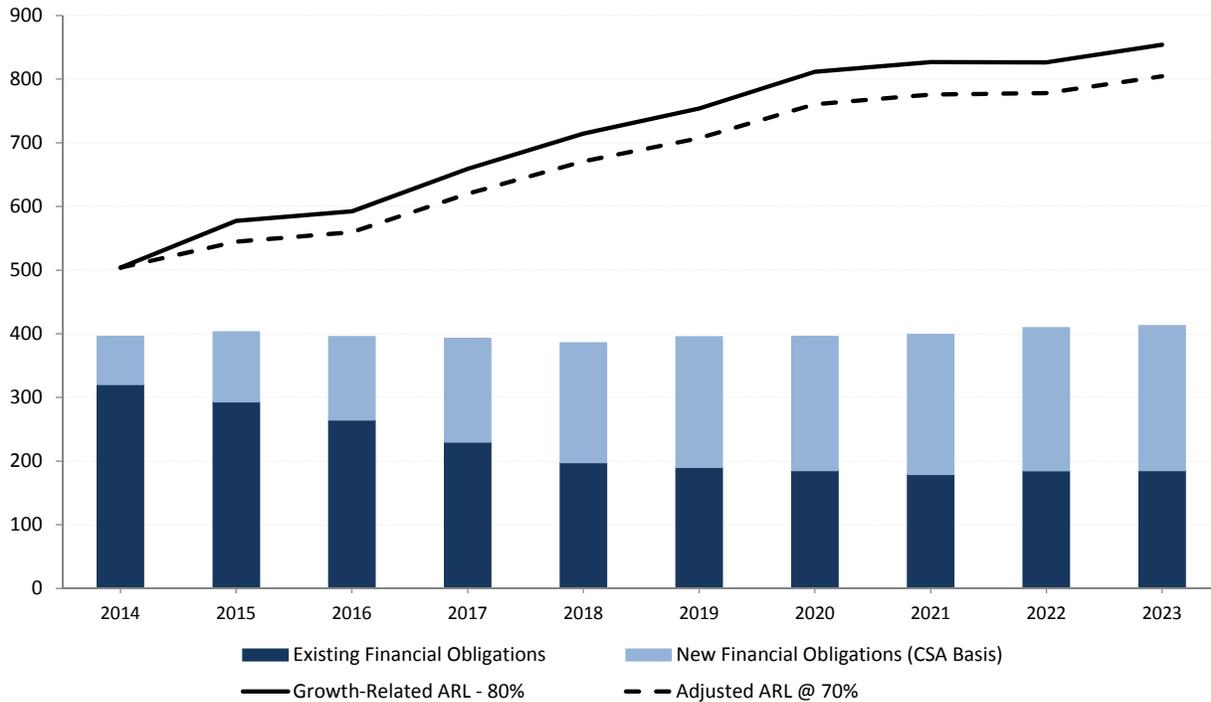
### **3. Risk and Mitigation Strategies Associated with the Region’s Long-Term Debt Strategy, Including Interest Rate Risk and Foreign Currency Exposure**

**Anticipated development charge collections represent one of the most significant risks to remaining within the ARL**

Development charge collections are difficult to predict from one year to the next and can vary significantly as economic conditions change over time. Lower-than-forecast DC collections could limit the Region’s debt issuing abilities to levels below those indicated in this plan and require changes in the phasing of the capital plan.

As a matter of normal practice, the Region’s capital plan will be measured against an adjusted ARL that uses only 70% of the three-year rolling average of historic DC collections as a cost supplement, versus the 80% permitted, unless specific Council approval is obtained to do otherwise. This would have the effect of partially mitigating the impact of lower-than-expected DC collections. However, the DC collections achieved in 2013 suggest that we will meet and even exceed anticipated collection levels. Given this added level of certainty, the ARL limit for 2014 has been calculated based on the full cost supplement permitted (e.g., 80%). The impact on the ARL calculations is illustrated in Chart 5.

**Chart 5**  
**Adjusted Annual Repayment Limit vs.**  
**Annual CSA Based Debt and Financial Obligations**  
**2013-2022**  
**(\$Millions)**



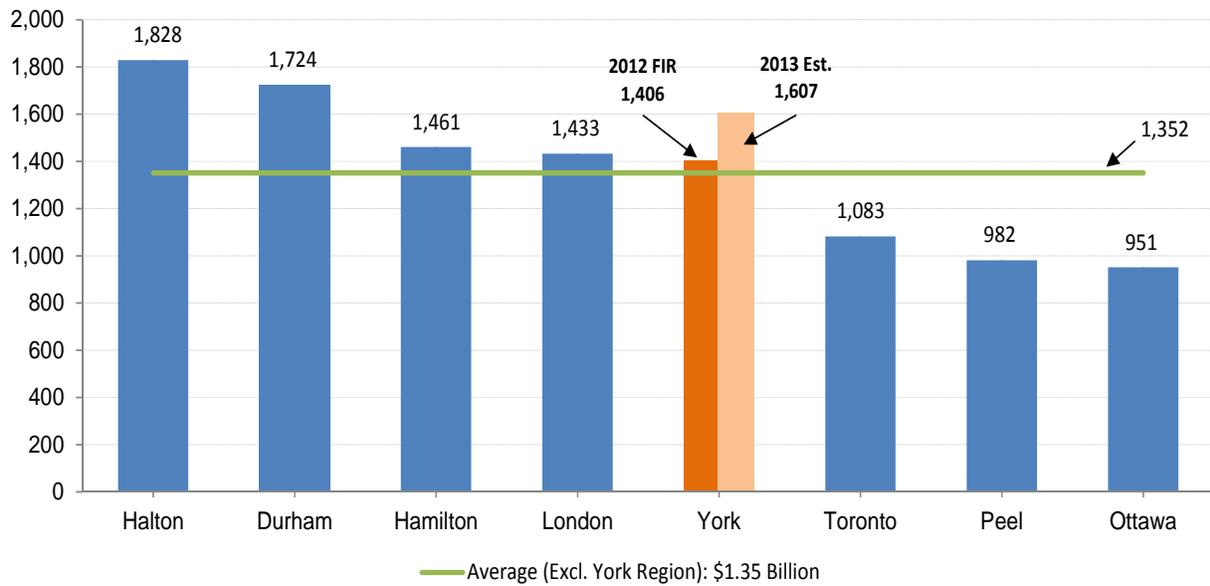
Source: York Region Finance Department

Lower-than-expected DC collections in any given year can result in a decrease in liquidity and debt servicing ability. To help mitigate this, it is Regional policy to maintain overall DC reserve balances that are at least equal to the next year’s estimated DC-related principal and interest obligations. Moreover, the Region maintains significant non-DC reserves (as detailed below) that could be used to fund DC-related projects and expenditures on an interim basis, should the need arise.

**Reserves are critical to the Region’s debt management plan**

In assessing the Region’s risk profile, credit rating agencies evaluate liquidity and consider reserves an indicator of fiscal prudence. Reserves also protect the Region against non-capital long-term liabilities and external shocks. The Region has been successful in building up a high level of reserves and remains above the average of comparable municipalities, as shown in Chart 6.

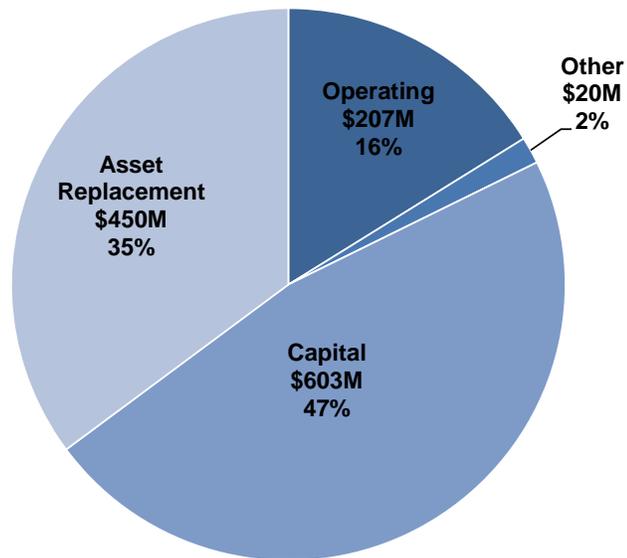
**Chart 6  
Reserves Per Capita Comparison  
(\$Millions)**



Source: Figures for comparator peer group are based on results summarized in 2012 Financial Information Returns.

The Region has a number of different non-growth reserves, broadly categorized into capital, asset replacement, operating, and other reserves, as summarized in Chart 7.

**Chart 7  
Summary of Non-DC Reserves  
Forecast December 31, 2013  
Total Non-DC Reserves: \$1.3 Billion**



Source: York Region Finance Department

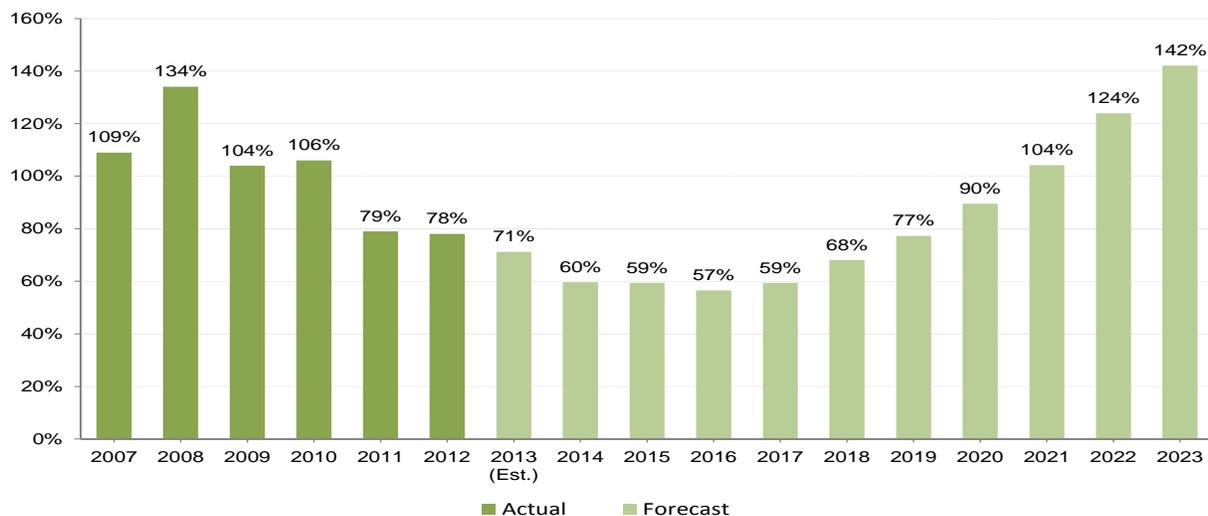
## The fiscal strategy involves continuing to build up reserves over time to help meet future capital funding requirements

As infrastructure ages, it periodically needs major (usually expensive) rehabilitation and ultimately needs to be replaced. Development charges cannot be used for this purpose, making it necessary to find other funding sources such as taxes and/or user rates. To minimize the impact that rehabilitation needs will have on tax/rate payers in any given year, debentures can be used to spread the costs out over time.

An alternative to issuing debt for capital rehabilitation and replacement is to build reserves for that purpose. Notwithstanding increased reserve and reserve fund draws included in the 2014 capital plan, the fiscal strategy recognizes the need to build up reserves over time to fund future capital needs. To this end, the contribution strategy introduced in 2006 and revised in the 2013 budget is maintained. Since 2006, annual contributions have been increasing by an increment equal to 1 per cent of the prior year's tax levy. In 2013, Council approved a policy to gradually increase the increment by 0.2 per cent each year until it reaches 2 per cent of the prior year's tax levy. Based on this plan, the annual contribution for 2014 is anticipated to be approximately \$61 million. It will increase to approximately \$114 million by 2017. In addition, annual operating surpluses help build reserves, in accordance with Council's approved surplus policy.

As illustrated in Chart 8, the ratio of reserves to debt has been decreasing as the need for growth-related debt continues to outpace the receipt of growth-related revenues. However, as a result of the measures contained in the fiscal strategy, the ratio will stabilize over the next four years and then trend sharply upward, reaching 142% by 2023.

**Chart 8**  
**Reserve to Debt Ratio**  
**Actual and Forecast**  
**2007-2023**



Source: York Region Finance Department

## **Reserves will be used to reduce tax-levy related debt requirements**

One way to mitigate the risks associated with the Region’s debt needs is to eliminate the debt need altogether. For this purpose, staff undertook a detailed review of debt-financed tax-levy-related capital expenditures to determine if cash funds on hand (i.e., reserves/reserve funds) could be used in place of debt. The analysis considered the magnitude of the expenditures and compared opportunity costs with financing costs to ensure the proper balance between reserves and debt. As a result, tax levy-related debt needs were reduced by a total of approximately \$417 million over the 2014 to 2023 forecast period. It is estimated that this will save approximately \$175 million in principal and interest costs over the same period.

## **We have built an increase into our expected costs of debt financing over time**

The forecast will be sensitive to interest rate fluctuations over the forecast period. For example, a 1% increase in interest rates would result in approximately \$0.68 million in additional financing costs for every \$100 million in debt, assuming a twenty-year term.

Interest rates are currently at historical lows and are expected to increase moderately in the near term. Interest rate assumptions have been adjusted based on a review of current and historic rates so as to incorporate the impact of increasing rates on the ARL. Moreover, interest rates are weight-averaged to incorporate the actual cash flow timing of a given year’s CSA commitment to reflect the multi-year nature of these projects. Interest rate assumptions are summarized in Table 2.

**Table 2  
Interest Rate Forecast  
2014-2023**

<b>Interest Rate</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>
Annual Estimate (%)	5.00	5.15	5.25	5.25	5.50	6.25	6.25	6.25	6.25	6.25
Weighted Average (%)	5.11	5.28	5.34	5.56	5.90	6.25	6.25	6.33	6.42	6.29

Interest rate fluctuations will also affect debt with refunding provisions. Refunding provisions occur where the debt amortization period (e.g., 20 years) is longer than the contractual terms (e.g., 10 years), requiring part of the debt to be refinanced for an additional term. For existing debt, this risk has been accounted for by calculating the annual repayment on the amount outstanding after the contract term expires (e.g., 2019) using an additional ten-year term with an annual interest rate of approximately 5.25%. For new debt, forecasted annual repayments have been calculated at the rates noted in Table 2 using a twenty-year term.

## **We have the ability to offset market risk through a variety of mechanisms**

Given the volatility of financial markets in recent years, there is a risk that the market may not be able to absorb the issuance of new debt at the specific time when it is needed.

Interest/market risk mitigation strategies that will be employed to deal with this eventuality include:

- Use of bond forward agreements to hedge interest costs
- Pre-financing
- Borrowing applications to government agencies such as Infrastructure Ontario
- Limiting the use of debt repaid from tax levy where the amortization period differs from the term of the debt
- Use of variable rate debt/lines of credit or short-term borrowing from reserves during periods of market turmoil or in anticipation of significantly lower interest rates
- Use of underwriting syndicates
- An Investor Relations program.

## **The debt management plan has other risks**

Other risks relate to the forecast of capital infrastructure costs. Factors such as change orders, inflation, the addition of new projects, or projects being moved forward in the capital plan could result in higher debt requirements than are anticipated in this Plan. It is now Regional policy to prioritize projects each year as part of the budget process to ensure sufficient debt financing is available for the highest priority projects. In addition, phase-in strategies for large capital projects will also be considered when appropriate.

## **4. Long-Term Debt and Financial Obligations Policy**

Council has approved a Capital Financing and Debt Policy that guides the overall management of the Region's current and expected financing needs and underpins this long-term debt management plan. This policy, last updated and approved by Council in 2011, is under constant review to identify and incorporate best practices.

The policy covers all long-term financial obligations entered into by the Region. It establishes objectives, standards of care, authorized financing instruments, and reporting requirements and responsibilities, so as to ensure that the Region's infrastructure needs are financed as effectively as possible.

## **5. Prudent and Cost-Effective Management of Existing and Projected Long- Term Debt and Other Financial Obligations**

The Region's Capital Financing and Debt Policy sets out provisions to manage existing and projected long-term debt and other financial obligations in the most prudent and cost-effective manner possible. These provisions include:

- Parameters and risk considerations for financing leases, which can be used in certain circumstances where long-term debt financing is neither feasible nor appropriate (i.e., lease vs. buy)
- Diversification and optimization of the term structure of debentures through a review of interest rate curves
- Limiting the term of financing to the lesser of the anticipated useful life of the underlying asset or the period over which repayment will occur
- Ensuring a high standard of care by ensuring that staff are sufficiently knowledgeable with respect to standard financing transactions and/or the use of outside advice when necessary
- Maintaining an investor relations program in order to increase market awareness and boost demand for Regional debentures
- Maintaining at least a AA- credit rating to minimize interest costs and maximize access to capital markets
- Use of an underwriting syndicate to facilitate the marketing and selling of debenture issues.

## **6. Estimated 2014 Needs of the Region for Temporary Borrowing**

### **Temporary borrowing needs arise from the need to finance operational expenditures pending receipt of taxes and other revenues**

The Region's temporary borrowing requirements are addressed in detail under a separate report to Council. In 2014, it is estimated that approximately \$325 million will be required for operating needs. Temporary borrowing can also result from the need to interim finance capital expenditures until long-term financing is in place. In 2014, it is estimated that approximately \$350 million will be required for interim capital financing.

Similar to long-term debt and financial obligations, the Province limits the amount of funding used for temporary borrowing needs to 50% of budgeted total revenue from January to September and 25% from October to December.<sup>3</sup> The Region's estimated temporary borrowing needs noted above are well within these limits. It is Regional policy to fund these short-term needs out of reserves and this is expected to continue in 2014. Any funds borrowed from reserves are always paid back during the year of borrowing.

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<sup>3</sup> Temporary borrowing provisions are set out in Section 405 and 407 of the Municipal Act. Temporary borrowings are not part of the ARL calculations.

## 7. Evaluation and Comparison of 2013 Projections and Outcomes

As Table 3 shows, the Region was in compliance with its ARL for 2013.

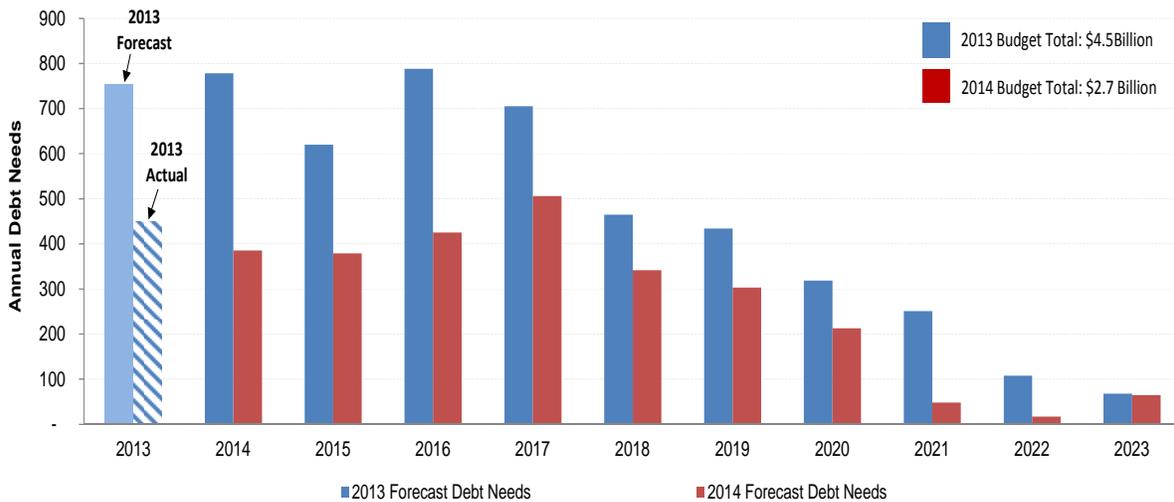
**Table 3**  
**Region's 2013 ARL**  
**(\$Millions)**

Component Description	Forecast	Actual	Difference
25% of Own Source Revenues	293	293	-
Plus: Growth Cost Supplement <sup>1</sup>	182	208	26
<b>Total ARL</b>	<b>475</b>	<b>501</b>	<b>26</b>
Less: Existing Debt Payment and Financial Obligations	298	295	(3)
Less: Anticipated New Debt Payment and Financial Obligations	154	154	-
<b>Remaining ARL (&gt;\$0)</b>	<b>23</b>	<b>52</b>	<b>29</b>

1. DC collections for 2013 are estimated to be \$179 million based on year-to-date collections as of October 29, 2013

A year-over-year comparison of annual debt requirements is shown in Chart 9.

**Chart 9**  
**Comparison of CSA Debt Needs**  
**2013 Budget vs. 2014 Budget**  
**2013-2022**  
**(\$Millions)**

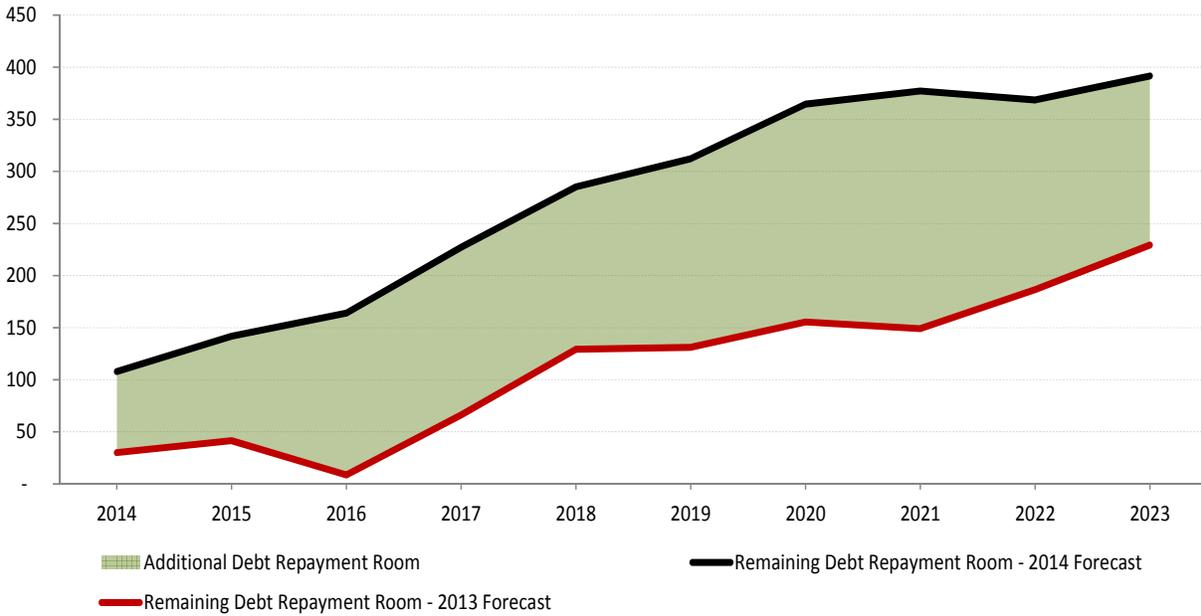


Source: York Region Finance Department

The capital plan included in the 2014 budget shows a total debt requirement of \$2.7 billion over the 2014-2023 period. This represents a \$1.8 billion decrease from the debt requirements identified for the same period in 2013, primarily due to fiscal strategy measures noted earlier.

As illustrated in Chart 10, the decrease in debt requirements has reduced the pressures on the Region’s ARL identified in previous forecasts and has provided additional annual debt repayment room. This will also help to further mitigate other risks such as DC collection uncertainty and interest rate risk. Overall, the Region has improved its ability to deliver the capital budget.

**Chart 10**  
**Comparison of Forecasted Remaining**  
**Annual Repayment Room**  
**2013 vs. 2014**  
**(\$Millions)**



Source: York Region Finance Department

## 8. Conclusion

The long-term debt management plan addresses the matters that Council is required to consider before adopting the plan. The financing that the Region requires to fund and manage its capital plan is within its Annual Repayment Limit. Staff will continue to assess the long-term implications of the ARL methodology as outlined in the Regulation.

## **APPENDIX 1: Determination of Annual Repayment Limit (ARL)**

### **Step 1: Calculate 25% of Own Source Revenue**

Own source revenue includes:

- Property tax revenue
- Water and wastewater revenues
- Transit fares
- Fees provided for police services, public housing rents, and fees from services provided to other municipalities.

Own source revenue does not include development charges, grants and subsidies from other levels of government, other deferred revenues (e.g., gas tax revenues), and contributions from reserves.

Table A1 provides the 2014-2023 forecast based on information and assumptions contained in the 2014 Operating Budget.

**Table A1**  
**Annual Repayment Limit Calculation – 25% of Own Source Revenues**  
**Forecast Budget Years 2014-2023**  
**(\$Millions)**

ARL Determination	Budget Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
	FIR Year <sup>1</sup>	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Net Revenues</b>											
Property Taxes/PIL's <sup>2</sup>		847	861	892	928	964	1,003	1,041	1,080	1,119	1,161
User Rates - Sewage/Water/Solid Waste		221	239	259	287	314	335	355	358	372	386
Transportation User Fees		52	55	57	58	63	57	62	64	65	66
Other User Fees <sup>3</sup>		33	27	29	30	31	32	33	34	34	34
Provincial Fines		10	12	13	13	13	13	13	14	14	15
Other Revenue <sup>4</sup>		84	72	67	70	75	86	107	132	151	168
<b>Total - Net Revenues<sup>5</sup></b>		<b>1,247</b>	<b>1,266</b>	<b>1,317</b>	<b>1,386</b>	<b>1,460</b>	<b>1,526</b>	<b>1,611</b>	<b>1,682</b>	<b>1,755</b>	<b>1,830</b>
<b>25% of Net Revenues</b>		<b>312</b>	<b>317</b>	<b>329</b>	<b>347</b>	<b>365</b>	<b>382</b>	<b>403</b>	<b>421</b>	<b>439</b>	<b>458</b>

**Notes:**

1. Own Source Revenues from two years prior to the current year are included in current year ARL calculations as represented by FIR Year. FIR Year 2014 is based on actual results. FIR Years 2013-2018 are based on the 2014 Operating Budget and departmental estimates for outlook years.
2. Property Taxes for 2014 assume approximately 2.06% assessment growth plus 1.54% net tax levy growth for a total of 3.60%. Property Taxes for FIR Year 2014-2018 are based on adjusted outlook assumptions and are assumed to grow at an average annual rate of 3.9% and for the remaining years, 3.7% (e.g., FIR Years 2019-2021).
3. Other User Fees include revenues generated by: Police Services, Public Health, EMS, Community and Health Services, Social Housing, and Planning. These are assumed to grow at an average annual rate of 2.7% over the forecast period (e.g., FIR Years 2012-2021).
4. Other Revenue includes: Investment Income, Sale of Publications etc., and recoveries.
5. Total Net Revenues equal total budgeted net revenues from the 2014 Operating Budget and departmental estimates of the outlook years. These are forecast to increase at an average annual rate of 4.6% over the forecast period (e.g., FIR Years 2014-2020).

**Step 2: Calculate Growth Cost Supplement**

The growth cost supplement is based on development charge collections. The Regulation allows the Region to include an amount equal to 80 per cent of the average DC collections for the previous three fiscal years. A forecast of DC collections is also required as part of this plan.

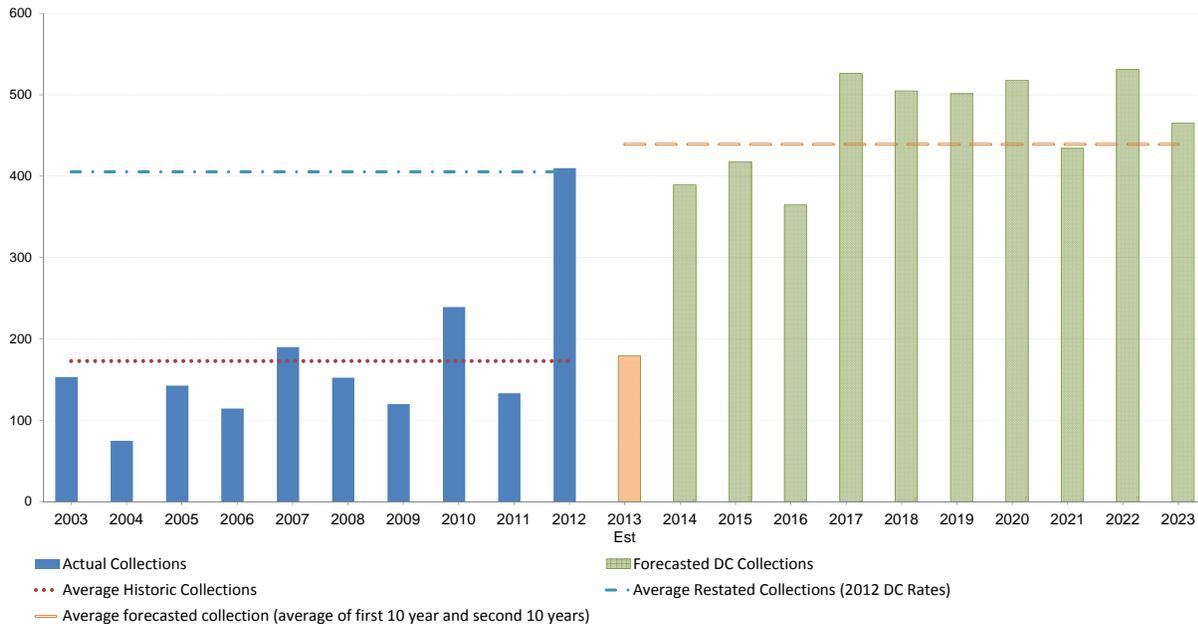
The DC collections forecast was developed for 2014 to 2023. A DC collection estimate was generated for 2013, based on the actual year-to-date collections realized by September, and historic trends in monthly DC collections.

DC collections are very sensitive to economic conditions and regional policies, and collections can vary widely from year to year. The collection forecast is calculated based on:

- Historic trends in residential building permits, population growth and household size
- Historic trends in the relationship between residential building permits and interest rates
- Population and employment projections that are consistent with the Region’s Official Plan and the Growth Plan
- Recent data on average gross floor area of non-residential developments
- Recent trends in the relationship between employment growth and non-residential construction activity
- Policies regarding DC prepayments, deferrals, and exemptions

Historic and forecast DC collections are provided in Chart A1 below.

**Chart A1  
Annual DC Collections Actual and Forecast  
(\$Millions)**



Source: York Region Finance Department

Over the ten year period 2003-2012, annual collections have averaged approximately \$173 million<sup>4</sup>, with peaks in 2012, 2010, and 2007 due to developer prepayments resulting from rate increases. The 2013 collection is estimated to be \$179 million. Collections were significantly lower in 2008 and 2009 due to the recession. The actual historic average collection level is not a good indicator of future average collections because the Region has stopped the practice of phasing in DC rate increases.

Average collections are anticipated to increase to approximately \$439 million annually from 2013- 2023. This is largely due to the fact that the Region is anticipated to continue to grow and the discontinuation of phase-ins.

### **Step 3: Calculate Total ARL**

The final step is to calculate the total ARL by adding the revenues and collections calculated in Steps 1 and 2 above, as summarized in Table A2.

**Table A2  
Total ARL  
2014-2023  
(\$Millions)**

Component	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Own Source Revenues	1,247,430	1,266,001	1,317,452	1,386,212	1,461,395	1,525,979	1,611,918	1,680,885	1,755,521	1,831,219
Own Source Revenues at 25%	311,858	316,500	329,363	346,553	365,349	381,495	402,980	420,221	438,880	457,805
DC Collections (3-year rolling avg.)	239,906	326,091	328,779	390,568	436,308	465,327	510,882	507,998	484,427	495,068
DC Cost Supplement - %	80%	70%	70%	70%	70%	70%	70%	70%	70%	70%
DC Cost Supplement - \$	191,925	228,264	230,145	273,398	305,416	325,729	357,617	355,599	339,099	346,547
Growth Related Debt and Fin. Ob. Limit (ARL)	503,782	544,764	559,508	619,951	670,765	707,224	760,597	775,820	777,979	804,352

### **Note:**

1. While the Regulation allows the Region to include an amount equivalent to 80% of the average DC collections for the previous three fiscal years as growth cost supplement, the 2015 to 2023 ARL is calculated based on 70% DC collection for conservative projection purposes.

<sup>4</sup> Note that if 2012 DC rates are applied to the historic level of registration and building permits, the average collection between 2003 and 2010 is estimated to be approximately \$405 million.



## **APPENDIX 2: Capital Financing and Debt Policy**





STATUS: Final  
Council Approved: Y  
CAO Approved: N/A

<b>TITLE:</b> Capital Financing and Debt	<b>Edocs No.:</b> 1927986 <b>Original Approval Date:</b> January 23, 2003 <b>Policy Last Updated:</b> December 19, 2013 <b>Posted on Intranet:</b> January 21, 2014
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**POLICY STATEMENT:**

A policy governing the use and administration of capital financing and debt.

**APPLICATION:**

All financial obligations including related agreements and capital financing leases that are entered into by the Corporation, its boards and subsidiaries as well as those employees responsible for the control, administration or management of capital financing and debt issuance activities.

**PURPOSE:**

This policy establishes objectives, standards of care, authorized financing instruments, reporting requirements and responsibilities for the prudent financing of the Corporation’s operating and infrastructure needs.

**DEFINITIONS:**

**Amortizing Debentures:** Debentures for which the total annual payment (principal and interest) is approximately even throughout the life of the debenture issue.

**Annual Repayment Limit:** For the purpose of this Policy it has the same meaning as the Debt and Financial Obligation Limit

**Area Municipality:** Any municipality located within the Region of York.

**Banker’s Acceptance:** A short-term credit obligation created by a non-financial firm such as the Corporation and guaranteed by a bank as to payment.

**Bond Forward Agreement:** A financial contract with an eligible Schedule I, II or III bank used to hedge future interest rates by short selling a particular Government of Canada or Province of Ontario bond and repurchase the same bond at a predetermined future settlement date. A settlement payment may be required by either the issuer or the bank if there is a difference between the price at which the government debt instruments are sold and the price at which they are bought back on the settlement date.

**Bought Deal:** A financing transaction, such as a debenture issue, in which an individual underwriter or underwriting group purchases the entire amount in order to resell to investors.

**Capital Financing:** A generic term for the financing of capital assets using debt, financing leases, swaps and other derivatives.

**Construction Financing:** A form of debt financing in which the issuer does not pay any principal and/or interest for a period up to 5 years during the construction or rehabilitation of the facility from which a revenue stream is expected to be generated.

**Corporation:** Refers to the Corporation of the Regional Municipality of York.

**Cross-Border Lease:** A lease in which the lessor and lessee are located in different countries, and where the holder of legal title to the asset can claim tax benefits in its home country, while the tax laws of the asset user treat it as owner for tax purposes in its own country.

**Debenture:** A formal written obligation to repay specific sums on certain dates. In the case of a municipality debentures are typically unsecured.

**Debenture Committee:** A committee established by Regional Council on September 23, 2010 through enactment of Bylaw No. 2010-69 which has the authority to enact Debenture Bylaws under the Terms of Reference contained in that bylaw.

**Debt and Financial Obligation Limit:** A calculation provided annually to a municipality by the Ministry of Municipal Affairs and Housing that determines the maximum amount of new annual debt servicing costs that a municipality can undertake or guarantee without seeking the approval of the Ontario Municipal Board. **For purposes of this Policy it has the same meaning as the Annual Repayment Limit.**

**Debt:** Any obligation for the payment of money. For Ontario municipalities, debt would normally consist of debentures as well as either notes or cash loans from financial institutions but could also include loans from reserves. Debentures issued to Infrastructure Ontario are also considered as debt.

**Financial Guarantee:** An agreement whereby the Corporation will take responsibility for the payment of debt in the event that the primary liable fails to perform.

**Foreign Currency Debentures:** Debentures that are denominated or payable in a foreign currency. In Ontario a municipality is permitted to issue debentures denominated in United States dollars, Pound Sterling, Japanese Yen and Euros.

**Foreign Currency Exchange Agreements:** An agreement entered into with a financial institution to fix the rate of exchange for future payments made in a foreign currency.

**Growth-related Cost Supplement:** A Supplement to the Debt and Financial Obligation Limit equal to 80 per cent of the average of the previous three calendar years of development charge collections.

**Growth-related Debt and Financial Obligation Limit:** The limit imposed by the Province with respect to the Corporation's debt and financial obligation payments comprised of the total of the Debt and Financial Obligation Limit and the Growth-related Cost Supplement.

**Hedging:** A strategy used to offset or mitigate currency and/or interest rate risk.

**Infrastructure Ontario (IO) or its successor organization:** Any entity established by the Province of Ontario to provide Ontario municipalities, universities and hospitals access to alternative financing service for longer-term fixed rate loans for the building and renewal of public infrastructure.

**Installment (Serial) Debentures:** Debentures of which a portion of the principal matures each year throughout the life of the debenture issue.

**Interest Rate Exchange Agreements:** An agreement entered into with a financial institution to fix the future rate of interest paid on a variable rate debenture or long-term bank loan.

**Joint and Several:** An obligation that may be enforced against all obligors jointly or against any one of them separately.

**Lease Financing Agreements:** A lease allowing for the provision of Municipal Capital Facilities if the lease may or will require payment by the Corporation beyond the current term of Council.

**Long-Term Bank Loan:** Long-term debt provided by a bank or a syndicate (group) of banks.

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

**Long-Term Debt and Financial Obligation Management Plan:** A plan to be completed and affirmed by Regional Council as part of the Corporation's annual budget to comply with Ontario Regulation 403/02 in order to access the Growth-related Cost Supplement.

**Municipal Capital Facilities:** Includes land, as defined in the *Assessment Act*, works, equipment, machinery and related systems and infrastructures.

**Non-Material Leases:** A class of financing leases in which the annual payment for individual leases will be less than \$250,000 and as a class does not exceed one percent (1%) of the Corporation's net tax levy; or the net present value of the annual payments is less than \$2 million for the term of the lease agreement, including possible extensions or renewals for which approval to extend or renew has been delegated to an officer of the Corporation.

**Project Financing:** Financing in which principal and interest payments are structured so as to more closely match the revenues or cost savings of a specific project. Also includes financing for which the lender, in the case of default, would have no or limited recourse to the issuer beyond the assets purchased with the proceeds of the financing.

**Refunding:** As applied to debentures, describes the process of retiring existing debt by issuing new securities to either reduce the interest rate or extend the maturity date or both.

**Rent:** A payment made by the Region in respect of property which will be used for the Region's purposes and for which a formal ownership transaction does not take place. Rent includes all payments made to the owner of the property.

**Retirement Fund Debentures:** Debentures for which money is accumulated on a regular basis, commencing several years after the issuance of the debentures, in a separate custodial account that is used to redeem the debentures.

**Rolling Stock:** Equipment that moves on wheels used for transportation and/or transit purposes. Examples include subway cars, trucks, buses and tractor trailers.

**School Board:** Any school board which has jurisdiction within the Region of York.

**Short-Term Debt:** Any debt for which the repayment of all the principal is due within one year.

**Sinking Fund Committee:** A committee consisting of the Corporation's Commissioner of Finance and Treasurer and other persons appointed by Council who are responsible for the management of the sinking and/or retirement funds.

**Sinking Fund Debentures:** Debentures for which money is accumulated on a regular basis in a separate custodial account that when combined with interest earned is used to redeem the debentures.

**Syndicated Bank Loans:** A loan between the Corporation and a bank listed in Schedule I, II or III of the *Bank Act (Canada)*, a loan corporation registered under the *Loan and Trust Corporations Act* or a credit union to which the *Credit Unions and Liaison Populaires Act, 1994* applies where the financing to the loan is obtained through a financing agreement in which each of the institutions that is a party of the term agreement agrees to contribute a portion of the loan.

**Tender:** A process whereby formal bids are submitted to acquire debt securities or to provide a lease.

**Term Debentures:** Debentures that are comprised of a combination of installment and sinking fund debentures.

**Tile Drainage Debentures:** Debentures issued to finance the construction of a tile drainage system for agricultural land.

**Underwriter(s):** An individual or group of investment bankers appointed for the purpose of purchasing and reselling new debentures issued by the Corporation at a negotiated price.

**Variable Interest Rate Debentures:** Debentures that provide for one or more variations in the rate of interest payable on the principal during the term of the debenture.

**DESCRIPTION:****A) PHILOSOPHY FOR CAPITAL FINANCING AND DEBT ISSUANCE**

Council may, where it is deemed to be in the best interest of its taxpayers, approve the issuance of debt for its own purposes, or those of its municipal business corporations, area municipalities and/or school boards.

"Best interest" will be consistent with the philosophy of the Corporation's *Financial Mission Statement*, adopted by Council in 1999, which includes the following key financial principle with respect to capital financing and debt practices:

*"Capital financing and debenture practices will be responsive and fair to the needs of both current and future taxpayers and will be reflective of the underlying life cycle and the nature of the expenditure."*

This philosophy will be met through the objectives outlined below.

**B) PRIMARY OBJECTIVES OF THE CAPITAL FINANCING AND DEBT PROGRAM**

The primary objectives for the Corporation's capital financing and debt program, in priority order, shall be:

- Adhere to statutory requirements;
- Maintain a superior credit rating;
- Ensure long term financial flexibility;
- Limit financial risk exposure;
- Minimize long-term cost of financing; and
- Match the term of the capital financing to the lesser of the useful life of the related asset or the period over which third party funding for the retirement of the debt will be received.

**1) Adhere to Statutory Requirements**

Capital financing may only be undertaken if and when it is in compliance with the relevant sections of the *Municipal Act*, the *Local Improvement Act*, or the *Tile Drainage Act*, and their related regulations. Requirements include but are not limited to the following:

- a) The term of temporary or short-term debt for operating purposes will not exceed the current fiscal year;
- b) The term of the capital financing will not exceed the lesser of 40 years or the useful life of the underlying asset;

- c) Long-term debt will only be issued for capital projects;
- d) The total annual financing charges cannot exceed the Growth-related Debt and Financial Obligation Limit or the Debt and Financial Obligation Limit, as applicable, for the municipality responsible for incurring the debt unless otherwise approved by the Ontario Municipal Board;
- e) Council has adopted or affirmed a Long-Term Debt and Financial Obligations Management Plan for each fiscal year that a Growth-related Cost Supplement is required;
- f) 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;
- g) 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;
- h) A credit rating of AA - (or equivalent) will be maintained for the year and the prior year that a Growth-related Cost Supplement is required; and
- i) Long-term debt will be the joint and several obligations of the Corporation and its area municipalities.

Furthermore, the awarding of any contract under this Policy, unless otherwise authorized by Council, will follow the procedures and authorities set out in the Corporation's Purchasing By-law.

## **2) Maintain a Superior Credit Rating**

Maintaining a superior credit rating is a key factor in minimizing the cost of debt and accessing capital markets in an efficient manner. Also, as noted elsewhere, a credit rating of a least AA - (or equivalent) will be needed by the Corporation to meet the statutory requirements for entering into certain types of capital financing contemplated by this Policy.

Successfully fulfilling the primary objectives identified above is important for maintaining high credit ratings from the Standard and Poor's Ratings Services and Moody's Investors Service. However, it is recognized that some factors may be out of the Corporation's direct control, such as the performance of the economy, that could inhibit the growing and stable source of revenue desired by the rating agencies. In part to mitigate this concern, the Corporation has a Reserve and Reserve Fund Policy that ensures its ability to pay operational and financial obligations even if the economy suffers setbacks or other contingencies arise.

Development charges, which are a major source of funding to repay growth-related debt, are particularly sensitive to the underlying economic conditions. Having an adequate Development Charge Reserve balance demonstrates to the rating agencies an ability to meet growth-related debt obligations even during periods when collections may temporarily decline.

Therefore, it will be the Corporation's practice to maintain a cash balance in its Development Charge Reserves equal to at least the projected annual principal and interest payments during the fiscal year for growth-related debt.

### **3) Ensure Long-Term Financial Flexibility**

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

Prior to the issuance of any new capital financing, consideration will be given to its impact on future ratepayers in order to achieve an appropriate balance between capital financing and other forms of funding.

To the extent practicable, replacement assets as well as regular and/or ongoing capital expenditures will be recovered on a "pay as you go" basis through rates, tax levy, user fees and/or reserve fund monies. It is recognized that adequate reserves must be developed and maintained for all capital assets owned by the Corporation to ensure long-term financial flexibility. However, where long-term financing is required, due consideration will be paid to all forms of financing including debentures, construction financing long-term bank loans and lease financing agreements.

### **4) Limit Financial Risk Exposure**

The capital financing program will be managed in a manner to limit, where practicable, financial risk exposure. As a result, it will be the Corporation's normal practice to issue debt that is only denominated in Canadian dollars with an interest rate that will be fixed over its term.

Notwithstanding, if a situation arises where there is a material financial advantage and/or it is deemed prudent for the Corporation to issue debt that is subject to fluctuations, in foreign currency and/or interest rates, a hedging strategy will be considered to either reduce or eliminate the risk.

This strategy would include the following:

- a) For debentures that are not denominated in Canadian currency, the rate of exchange will be fixed for the term of the obligation (both principal and interest payments) on or before the date of issuance.
- b) For variable interest rate debentures with a term exceeding one year, the interest rate will be fixed within six months of the issuance date.

However, long-term bank loans for which the interest rate may vary will not be fixed if prevailing market conditions are such that in the opinion of the Commissioner of Finance it is in the Corporation's best interests to allow the rate to float where such debt, in addition to

any other outstanding variable rate loans or debentures, do not exceed fifteen percent (15%) of the total outstanding debt of the Corporation as authorized by O.Reg 276/02 s(2).

Finally, it is recognized that financing leases have different financial and other risks than traditional debt that must be considered, and where practicable mitigated prior to its use, including; contingent payment obligations for items such as; lease termination provisions; equipment loss; equipment replacement options; guarantees and indemnities. These risks will be identified prior to entering into any material financing lease.

(Refer to Section E of this Policy – Financing Risk Identification and Mitigation Strategies.)

### **5) Minimize Long-Term Cost of Financing**

The timing, type and term of financing for each capital asset will be determined with a view to minimize both its and the Corporation's overall long-term cost of financing.

Factors to be considered will include: current versus future interest rates; shape of the interest rate curve, the availability of related reserve fund monies; the pattern of anticipated revenues or costs savings attributable to the project or purpose; the applicability of using bond forward agreements to hedge interest costs; and, all costs related to the financing of the project whether by debenture, construction financing or financing lease.

### **6) Match the Term of the Capital Financing to the Lesser of the Useful Life of the Underlying Asset or the Period over which Third Party Funding for the Retirement of the Debt will be Received**

The Corporation's normal practice will be to issue long-term debt for contractual terms that will be well received in the financial market place, typically 5, 10 or 30 years. However, the amortization period over which the debt will be retired may be longer, necessitating that part of the debt will need to be refinanced for an additional term (i.e., term debentures with a refunding provision). However, the maximum term over which a capital asset shall be financed will be set out in Appendix 1, unless otherwise specifically approved by Council. In no case shall the term of financing exceed the lesser of the anticipated useful life of the underlying asset or in the case of financing that will be repaid from third party funding (e.g., development charges), the period over which the funding will be received.

## **C) STANDARD OF CARE**

All officers and employees responsible for capital financing and debt activities will follow the standard of care identified in this Policy.

### **1) Ethics and Conflicts of Interest**

Officers and employees involved in the capital financing process are expected to abide by the Corporation's Code of Conduct.

In particular they shall:

- a) Refrain from personal business activity that could conflict with the proper execution and management of the capital financing program, or that could impair their ability to make impartial decisions;
- b) Disclose any material interests in financial institutions with which they conduct business;
- c) Disclose any personal financial/investment positions that could be related to the performance of their capital financing duties; and
- d) Not undertake personal financial transactions with the same individual with whom business is conducted on behalf of the Region.

## **2) Delegation of Authority**

The Commissioner of Finance and Treasurer will have the overall responsibility for the capital financing program of the Corporation. However, the Director of Policy, Risk and Treasury will have responsibility for directing/implementing the activities of the capital financing program as well as the establishment of procedures consistent with this Policy. Such procedures shall include explicit delegation of authority to persons responsible for capital financing activities. No person shall be permitted to engage in a capital financing activity except as provided for under the terms of this Policy. The Director will be responsible for all activities undertaken, and shall establish a system of controls to regulate the activities of subordinate officials and exercise control over that staff.

Notwithstanding, the Chief Administrative Officer, as authorized by the Purchasing By-law, may approve non-material financing leases as previously defined.

## **3) Requirement for Outside Advice**

The Corporation's staff will be expected to have sufficient knowledge to prudently evaluate standard financing transactions. However, should in their opinion the appropriate level of knowledge does not exist for instances such as capital financing transactions that are unusually complicated or non-standard, or as otherwise directed, outside financial and/or legal advice will be obtained.

## **D) SUITABLE AND AUTHORIZED FINANCING INSTRUMENTS**

The form of financing that meets the objectives listed above will be dependent in part upon its term and the type of asset to be financed.

### **1) Short-Term – Under One (1) Year**

Financing of operational needs for a period of less than one (1) year pending the receipt of taxes and other revenues, or interim financing for capital assets pending long-term capital financing may be from one or more of the following sources:

- a) Reserves and reserve funds. (This may be used as the primary source of short-term financing provided that interest is paid at the prevailing market rate);
- b) Bank line of credit;
- c) Short-term promissory notes issued to aforementioned institutions;
- d) Bankers' Acceptances; and
- e) IO (or its successor organizations) short-term advances pending issuance of long-term debentures.

**2) Long-Term – Greater than One (1) Year**

Financing of assets for a period of greater than one year may be from any of the following sources:

- a) Debentures (including those issued to IO or its successor organizations), which may be in the following form or a combination thereof:
  - Installment
  - Sinking Fund
  - Term (including those with a refunding provision)
  - Amortizing
  - Variable Interest Rate
  - Foreign Currency
  - Retirement Fund

b) Reserves and Reserve Funds

These may be used for both interim and medium-term for a period of no greater than five-year financing if deemed cost effective or otherwise necessary. It is recognized however, that reserves and reserve funds are for a defined purpose and must be available when that purpose occurs or requires them. Notwithstanding this policy, intrafund borrowing between development charge reserve accounts for a longer period of time is permitted if the funds are available.

c) Long-Term Bank Loans (including Syndicated Bank Loans)

These may be used if deemed cost effective or otherwise necessary. These loans may be either fixed or variable interest rate loans as determined by the Commissioner of Finance and Treasurer.

d) Construction Financing

May be used for a period up to five (5) years during construction or rehabilitation of certain facilities from which a revenue stream is expected to be generated (e.g., water plant) upon its completion.

e) Lease Financing Agreements (Capital Financing Leases)

May be used when it provides material and measurable benefits compared with other forms of financing. Capital financing leases may include cross-border and rolling stock leases.

f) Tile Drainage Debentures

These will be used to finance the construction of tile drainage systems for agriculture and for those individual farmers who apply and are accepted for financing.

### **3) Credit Rating Requirements for Issuing Certain Types of Debt**

The Corporation may only issue foreign currency debentures, variable rate debentures, or variable rate long-term bank loans if its long-term debt obligations are rated by:

- a) Dominion Bond Rating Service Limited as “AA (low)” or higher, or
- b) Fitch Ratings as “AA-“ or higher, or
- c) Moody’s Investors Service, Inc. as “Aa3” or higher, or
- d) Standard and Poor’s as “AA-“ or higher.

## **E) FINANCING RISK IDENTIFICATION AND MITIGATION STRATEGIES**

It is explicitly recognized that there may be additional risks associated with certain types of financing. It is expected that these risks will be identified and considered prior to their use in relation to other forms of financing that would be available. Also, the mitigation strategies discussed below will be used to reduce the additional risk when deemed practicable.

### **1) Availability of Debt Capacity for Future Priority Projects**

The Corporation could face the risk in any fiscal year of having insufficient debt capacity to fully execute its capital plan, based on its ARL or Growth-related Debt and Financial Obligation 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 also be prioritized on the basis of its impact on the Corporation’s growth plan and/or any strategic plan approved by Council. Project prioritization would permit the most critical elements of the capital plan to proceed in an expeditious manner.

### **2) Refunding Risk**

The Corporation may issue debentures for which the amortization to retirement period is longer than the contractual term of the debenture, similar to a home mortgage. For those

debentures, the balance of the debt remaining at the end of the contractual term will need to be refinanced.

A risk to the Corporation would be that interest rates may be higher during the second financing period, resulting in higher than anticipated debt payments. For this reason the use of refunding debentures will not be a preferred method of financing by the Corporation whenever tax levy is the primary source of funding. However, there will be no restriction to the use of refunding debentures funded mainly from development charges or user rates which tend to be for longer periods and are better able to absorb increases (or decreases) to their cost of financing over time.

Further risk to the Corporation may arise if market conditions are unfavorable to financing at the end of the first contractual term of a refunding debenture. In those situations, several strategies will be employed, including pre-financing, short term borrowing from reserves, using variable rate debt and lines of credit, and making borrowing applications to government agencies such as Infrastructure Ontario.

### **3) Construction Financing**

Construction financing may be used to “lock-in” the debt needed for a capital project that will eventually generate a revenue stream which could be used to make principal and interest payments (eg. water plant). Construction financing is unique in that the debt may be accrued in advance of the project’s completion and the interest accrues and no payments are made during the building period.

The following risks compared to other forms of financing will be considered prior to the use of construction financing:

- a) The financial risks include the following:
  - The possibility that interest rates may fall from the time the rate for the construction loan is established and completion of construction. Should there be a high probability of this occurring, staff will consider the use of variable interest rate rather than fixed rate financing as a method to mitigate this risk; and
  - The possibility that the final cost of construction could be materially less than initially forecasted and financed. Staff will consider whether or not to issue debt until a fixed rate contract has been awarded or to issue debt that does not exceed 75% of the projected cost as a method to mitigate this risk.
- b) Other risks include that the construction project may not be able to proceed or is not completed for technical or other reasons. The mitigation option to be considered in this case will be not to issue long-term debt until all critical construction contracts have been awarded.

### **4) Financing Lease Agreements**

Leases may be used to finance equipment, buildings, land or other assets that the Corporation does not have a long-term interest in or may not be able to acquire through other means.

The following risks compared to other forms of financing will be considered prior to the use of capital financing lease agreements.

- a) The financial risks include the following:
  - The ability for lease payment amounts to vary if based on changes in an underlying benchmark debt instrument (generally expressed as a particular Government of Canada Bond). This risk usually applies only to new assets being added to a leasing schedule and would be the same as new debt being issued from time to time;
  - The ability for lease payment to vary based on changes in the assumed residual values of the asset being leased. Again, this risk usually applies only to new assets being added to a leasing schedule and would not be riskier than other forms of financing;
  - Uncertainty over leasing costs if contract needs to be extended or renewed. The normal practice of the Corporation will be to negotiate these costs prior to the leasing agreement being executed; and
- b) Other risks include the potential for the seizure and removal of leased equipment if the leasing company goes into default of its obligations to creditors, and its creditors have the legal right to seize assets of the leasing company. The practice of the Corporation will be to assess the financial strength of the normal leasing company prior to the leasing agreement being executed.

## **5) Variable Interest Rate Debenture and Long-Term Bank Loans**

Variable rate debentures and long-term bank loans may be used when there is volatility in the financial market and/or there is an expectation of significantly lower interest rates occurring within a few months of their issue. In all cases, The interest rate will be fixed no later than 6 months after issue by means of a interest rate exchange (ie. hedging) agreement in order to mitigate the financial exposure.

The Corporation may only enter into interest rate exchange agreements as part of a variable rate debenture with an eligible institution whose credit ratings are equivalent to those cited in Section D(3) above.

## **6) Foreign Currency Debentures**

Foreign currency debentures may be used when the “all in” cost of financing in a foreign market is cheaper or the market conditions are such that domestic financing is not practicable. The risk associated with foreign currency debentures is that the rate of

exchange incurred for future interest and principal payments could significantly increase over the term of the debt, raising its overall cost.

The Corporation's practice with respect to foreign currency debentures will be to have the rate of exchange for all interest and principal payments fixed prior to their issue by means of foreign currency exchange or hedging agreement in order to mitigate the financial exposure.

The Corporation may only enter into a foreign currency exchange agreement with an institution whose credit ratings are equivalent to those cited in Section D(3) above.

Any foreign currency exchange agreement or agreements for a debenture will, when read together, provide for the reduction of currency risk with respect to the entire amount of principal and interest payable under the debenture and shall require any amount payable to any person under the agreement or agreements to be expressed as a Canadian currency amount.

The currencies set out in Appendix 2 are prescribed foreign currencies eligible under provincial regulation.

## **7) Bond Forward Agreements**

The timing of the Corporation's debenture issue is very dependent upon market or economic conditions prevailing at the time of each issue. Market-out conditions can occur due to issuance calendars and in times of financial crisis. Bond forward agreements allow the Corporation to lock-in the underlying interest rate on a portion of a planned debt issue, facilitating the issuing process.

Bond forward agreements may only be used for the issue or the refinancing of debentures denominated in Canadian currency for which Council approval has already been given.

Furthermore, it will be the Corporation's normal practice to limit bond forward agreements to apply to no more than seventy-five percent (75%) of the principal amount of debentures to be issued. Bond forward agreements will have a settlement date which is not longer than 60 days after the day on which the agreement is executed.

It will be the Corporation's normal practice that counterparty payments resulting from the use of these agreements, if material, will be added to or deducted from the principal of the amount being financed.

Utilizing bond forward agreements exposes the Corporation to the following risks:

- a) Credit risk to the counterparty (financial institution) in the event interest rates have risen and the counterparty cannot fulfill the terms of the agreement. Although this is considered a remote risk, credit exposure resulting from any or all outstanding bond forward agreements executed with any financial institution will be added to any outstanding investments held in the Corporation's investment portfolio and will be

- subject to the same limitation guidelines set out in Appendix 1 of the Investment Policy.
- b) There will be an opportunity cost if interest rates fall and the Corporation has to pay the counterparty to the bond forward agreement. This is recognized, however the primary use of a bond forward agreement is to “lock-in” the anticipated borrowing rate associated with the future debenture issue and reduce or eliminate the risk of higher interest rates. The Corporation’s practice of hedging less than 100% of the planned debenture issue would result in some of the savings still being achieved.

By not utilizing a bond forward agreement, the Corporation will be exposed to movements in interest rates that will be either beneficial or detrimental and will have less certainty about the cost of borrowing on a prospective debenture.

Before entering into a bond forward agreement, treasury staff and the Commissioner of Finance and Treasurer will analyze and provide:

- a) The fixed costs and estimated costs to the Corporation resulting from the use of such agreements.
- b) A detailed estimate of the expected results of using such agreements.

Bond forward agreement may only be entered into with a bank listed in Schedule I, II or III to the *Bank Act (Canada)* and only if the bank's long-term debt obligations on the day the agreement is entered are rated by:

- a) Dominion Bond Rating Service as “A(high)” or higher; or
- b) Fitch Ratings as “A+” or higher; or
- c) Moody’s Investors Service Inc. as “A1” or higher; or
- d) Standard and Poor’s as “A+” or higher.

## **F) METHODS OF MARKETING/SELLING DEBENTURE ISSUES**

Debenture securities may be sold by the following means:

- a) Underwriting Syndicate  
The use of an underwriting syndicate will be the normal method by which debentures will be sold by the Corporation; or
- b) Tender  
A tender process may be used when and if significant savings could be expected when compared to issuing through an Underwriting Syndicate; or
- c) Bought Deal/Private Placement  
This may be appropriate for only "one off" or unusual financing structures when significant savings would be expected or when market conditions are volatile or otherwise difficult.

**G) DEBT ISSUED ON BEHALF OF OTHER JURISDICTIONS**

Council may approve the issuance of debentures for the purposes of its area municipalities and school boards provided:

- a) They are used for capital projects approved by the Area Municipality and School Board;
- b) The term of the financing is in excess of one (1) year but does not exceed the guidelines set out in Appendix 1;
- c) It has received satisfactory evidence of approval authority and statutory compliance. Accordingly, the Financial Officers of the Area Municipalities must provide to the Corporation at the time of their financing request, an updated Debt and Financial Obligation Limit for their respective municipality and attest to the validity of the calculation in order to ensure compliance under the regulations of the Act. As well, mandated approvals from provincial ministries, if necessary, and the council of the Area Municipality will be required prior to Council granting financing approval;
- d) The issuance and administrative costs attributable to borrowings on behalf of Area Municipalities and School Boards will be recovered. Costs not directly or specifically attributed to any one participant shall be allocated on a prorata basis to all participants. Conversely, costs incurred which are directly or specifically attributable to any one participant shall be allocated as such. Such costs may include, but are not limited to, the following: legal fees; commissions; cost of certificates; registration and re-registration charges; and courier charges.

**H) FINANCIAL GUARANTEES AND LETTERS OF CREDIT**

Financial guarantees and/or letters of credit provided by the Corporation, its boards and subsidiaries will be considered as debt and will be governed by this Policy.

**I) SINKING/RETIREMENT FUND DEBENTURES**

A Sinking Fund Committee will be established whenever sinking and/or retirement fund debentures are outstanding anytime during a calendar year. The committee will meet at least annually and will be chaired by the Commissioner of Finance and Treasurer and will have at least two additional members appointed by Council. The committee will establish investment guidelines and ensure that adequate funds will be available to retire the debt at its maturity.

When setting the internal capitalization rate for new sinking/retirement fund debt at the time of its issue, the rate shall not exceed the lesser of the rate allowed in the Municipal Act, or the 5-year Government of Canada bond rate at time of issue.

**J) REPORTING REQUIREMENTS**

In addition to any information requested by Council or that the Commissioner of Finance and Treasurer considers appropriate, the following reports will be provided:

- 1) Annually, the Commissioner of Finance and Treasurer shall submit to Council a report or reports that:
  - a) Requests authority for temporary borrowing up to a stipulated amount to meet day-to-day expenditures, pending receipt of tax levies, user fees and revenues anticipated during the year;
  - b) Requests authority, if required, to finance certain capital items detailing for each type of item, the amount and the maximum term of financing;
  - c) States the sum, if any, that must be raised for sinking fund purposes in that year;
  - d) As part of the annual budget a Long-Term Debt and Financial Obligation Management Plan to be adopted or affirmed by Regional Council that will contain at least the following elements:
    - Projections for each year over a multi-year period of estimated long term debt and financial obligations payments compared to the Growth-related Debt and Financial Obligation Limit;
    - Strategies for prudently and cost effectively dealing with risks associated with planned long term debt and financial obligations and mitigation strategies for adverse contingencies which might arise;
    - An evaluation of the outcomes of the previous year's Long-Term Debt and Financial Obligations Management Plan as well as a comparison to the current year's plan;
    - A statement indicating the Plan is in compliance with this Policy.
- 2) As required, the Commissioner of Finance shall submit to Council, the following:
  - a) A report, before entering into a financing lease which is other than a non-material lease with a recommendation assessing the costs and financial and other risks associated with the proposed financing lease. This report shall include:
    - A comparison between the fixed and estimated costs and the risks associated with the proposed lease and those associated with other methods of financing;
    - A statement summarizing, as may be applicable, the effective rate or rates of financing for the lease, the ability for lease payment amounts to vary, and the methods or calculations, including possible financing rate changes, that may be used to establish that variance under the lease;
    - A statement summarizing any contingent payment obligations under the lease that in his or her opinion would result in a material impact for the municipality, including lease termination provisions, equipment loss, equipment replacement options and guarantees and indemnities;

- A summary of the assumptions applicable to any possible variations in the lease payment and contingent payment obligations; and
- b) Lists of any outstanding financing leases including the following details:
- Estimates of the proportion of financing leases to the Corporation's total long-term debt and provides a description of any change in that proportion since the previous year's report; and
  - A statement that in his or her opinion all financing leases were made in accordance with the lease policy and goals as outlined in this Policy or as otherwise adopted by Council.
- c) A statement before passing a by-law providing for construction financing, which shall consider:
- The fixed and estimated costs to the Corporation;
  - Whether the costs of the proposed financing for the construction of the undertaking are lower than other methods of financing available;
  - A detailed estimate with respect to the terms of the Corporation's expectations of revenue generation from the undertaking, once constructed;
  - The risks to the Corporation if the undertaking is not constructed or completed within the period of construction as estimated by Council; and
  - The financial and other risks for the Corporation.
- d) A report detailing at least once in a fiscal year, any bond forward agreements in a fiscal year which the Corporation has entered into.

The report must contain the following information and documents:

- A statement comparing the expected and actual results of using bond forward agreements during the period of the report; and
  - A statement indicating whether, in his or her opinion, all of the bond forward agreements entered during the period of the report are consistent with the bond forward policies and goals in this Policy or as otherwise adopted by Council.
- e) A report detailing at least once in a fiscal year, any subsisting variable interest rate bank loan agreements and any subsisting interest rate exchange agreements applicable to them.
- f) Lists any outstanding construction financing debentures including the following details:
- A description of the estimated proportion of the total debentures of the municipality issued to the total long-term debt of the municipality and a

- description of the change, if any, in that estimated proportion since the previous year's report;
  - A statement as to whether, in his or her opinion, all debentures issued were made in accordance with this construction financing policy and goals outlined in this Policy or as otherwise adopted by Council;
  - An update of the detailed estimate with respect to the terms of the municipality's expectations of revenue generation from the undertaking;
  - A record of the date of the repayment of each installment of principal, interest or both principal and interest made during the period of construction of the undertaking for which the debentures were issued;
  - A statement of the outstanding installments of principal, interest or both principal and interest repayable during the currency of the debentures issued that will be due and payable in each year; and
- g) Details of all outstanding hedging instruments related to foreign exchange, interest and swap agreements, describing type, amount and purpose; and
- h) A report detailing, at least once in a fiscal year, any outstanding variable interest rate debentures or foreign currency debenture and any subsisting interest rate or foreign currency exchange agreements applicable to them.
- 3) The Debenture Committee will report to Regional Council as required under the Region's Procedural Bylaw on each and every occasion it exercises its delegated authority.

## **RESPONSIBILITIES**

Officers and staff of the Corporation complying with this Policy shall have the necessary authority to carry out the responsibilities and duties identified therein the Policy.

In addition, the following specific responsibilities are identified:

- 1) Commissioner of Finance and Treasurer and/or Director of Policy, Risk & Treasury:
- Reviews and recommends the type and term of financing for capital projects and operating requirements;
  - Calculates the Growth-related Debt and Financial Obligation Limit for the Corporation as prescribed by the Municipal Act;
  - In consultation with the lead underwriters, approves the timing and structure of debt issues;
  - Coordinates the preparation of debt issue by-laws for Council or the Debenture Committee;
  - May execute and sign documents on behalf of the Corporation and perform all other related acts with respect to the issuance of debt securities;

- Liaises and assists rating agencies in the evaluation of the credit worthiness of the Corporation's debt securities;
  - Reviews and recommends to Council the financial and business aspects of any material lease agreements and transactions;
  - Ensures all reporting requirements identified within this Policy are met; and
  - Is a member of the Debenture Committee
- 2) Chair of Council
- May execute and sign documents on behalf of the Corporation with respect to the issuance of debt securities.
  - Is a member and Chair of the Debenture Committee
- 3) Regional Clerk
- The Regional Clerk may certify and sign documents on behalf of the Corporation with respect to the issuance of debt securities.
- 4) Chief Administrative Officer
- Is a member of the Debenture Committee
- 5) The Debenture Committee may exercise the authorities granted to it under Bylaw No. 2010-69 in terms of enacting bylaws authorizing the issuance of debentures.

**REFERENCE:**

Committee of the Whole Report 8, Clause 2, adopted by Council December 19, 2013

Finance and Administration Committee Report 9, Clause 1 adopted by Council November 17, 2011

Replaces Finance and Administration Committee Report 1, Clause 3 adopted by Council January 27, 2011

Replaces Finance and Administration Committee Report 7, Clause 6 adopted by Council September 23, 2010

Replaces Finance and Administration Committee Report 7, Clause 8 adopted by Council September 18, 2008

Replaces Finance and Administration Committee Report 1, Clause 2 adopted by Council January 23, 2003.

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Municipal Act, 2001, S.O. 2001, c. 25 Sections 405(1), 407(1), 408(3,4), 409(2)  
Local Improvement Act, R.S.O. 1990, c.L.26, Section 53(2)  
Tile Drainage Act, R.S.O. 1990, c.T.8, Section 2(1)  
Ontario Regulation 266/02 - Financing Leases for Municipal Capital Facilities  
Ontario Regulation 278/02 - Construction Financing  
Ontario Regulation 276/02 – Bank Loans  
Ontario Regulation 653/05 – Debt Related Financial Instruments and Financial Agreements  
Ontario Regulation 403/02 – Debt and Financial Obligation Limits

**CONTACT:**

Manager, Treasury and Reserves – Policy, Risk and Treasury Branch, Finance Department

**APPROVAL INFORMATION**

<b>CAO Approval Date:</b>	n/a		
<b>Committee:</b> Committee of the Whole	<b>Clause:</b> 2	<b>Report No:</b> 8	Edocs No. 5294362
<b>Council Approval:</b>	<b>Minute No.</b> 168	<b>Page:</b> 75	<b>Date:</b> December 19, 2013

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41059 Archived Policy dated January 23, 2003

## APPENDIX 1

### Maximum Financing Term of an Asset

#### 3 Years

- Computer software
- Police patrol vehicle

#### 4 Years

- General purpose vehicle
- Personal computer and monitors

#### 5 Years

- Mainframe computer/server and network equipment
- Radio and telecommunications system
- Office furnishings
- Audio and Video equipment
- Printers

#### 10 Years

- Specialized vehicle/equipment
- Parking lot
- Public Works facility (depot, dome, etc.)
- Solid waste equipment
- Transit vehicle
- Park, recreational facility
- Dock, wharf, pier, breakwater
- Retaining wall, embankment, flood control
- Sidewalk, path
- Tile drainage
- Street lighting
- Underground wiring

#### 15 Years

- Police station
- Health clinic
- Library
- Fire station

**20 Years**

- Water main, hydrant, filtration plant, storage facility, pumping station
- Sanitary sewer, storm sewer, treatment plant, pumping station
- Solid waste landfill site
- Home for the aged
- School, other educational building
- Office building
- Hospital
- Dam, reservoir
- Road
- Emergency Medical Services station

**Greater than 20 years**

- Major infrastructure –only when term approved by Regional Council

**30 Years**

- Water and wastewater main projects, subject to:
  - a) the underlying assets having a useful life of at least 30 years; and
  - b) the project being in receipt of dedicated revenues for a similar period.
- Housing projects, subject to:
  - a) the underlying assets having a useful life of at least 30 years; and
  - b) the project being in receipt of dedicated revenues for a similar period.

**APPENDIX 2**

**Prescribed Foreign Exchange Currencies**

1. Dollars of Australia.
2. Francs of France.
3. Marks of Germany.
4. Yen of Japan.
5. Guilder of the Netherlands.
6. Francs of Switzerland.
7. Sterling money of the United Kingdom.
8. Dollars of the United States of America.
9. The euro currency adopted by member states of the European Union.

O. Reg. 247/01, Sched.

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