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Town of Aurora

Debt Management

Finance

Contact: Senior Financial Management Advisor, Finance

Approval Authority: Council

Effective: January 17, 2023

Background

Acquisition of debt and debentures can play a very important role in the Town's finances. Debt can provide liquidity to fund new assets and infrastructure and fund other capital projects when the asset is built in advance of growth.

The fiscal strategy highlights that the debt financing can be used to manage the long-term financial flexibility of the Town. Debt is a financing tool which can be used by the Town to manage the timing difference between when a capital project is built and when the funding for the project is received. The Town should continue to use debt wisely over the long-term and understand that the prudent issuance of debt is an efficient use of available financial resources.

Objective

The purpose of the Debt Management policy is to establish financial guidelines and appropriate controls for the issuance and management of debt for the Town of Aurora. This policy establishes objectives, standards of care, authorized financing instruments, reporting requirements and responsibilities for the prudent financing of the Town's infrastructure needs.

Scope

This policy applies to the management of existing debt and all future debt financing that may be issued or planned by the Town of Aurora.

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: Maximum amount of annual debt servicing costs that the Town can undertake or guarantee without seeking the approval of the Ontario Land Tribunal. The annual amount is provided by the Ministry of Municipal Affairs and Housing and must be adjusted by the Treasurer in the prescribed manner prior to the authorization by Council of a long-term debt or financial obligation. Ontario Regulation 403/02 filed under the *Municipal Act, 2001*, S.O. 2001, c. 25 (the *Municipal Act, 2001* or the Act), provides a formula which limits the annual debt services costs to an amount equal to 25% of operating revenue (own sourced revenue which excludes development charges).

Annual Debt Financing Charges: The estimated amount of operating budget funds, in a respective year's approved budget, required to meet that year's share of mandatory payments in respect of outstanding debentures such as principal and interest.

Asset Management Reserve Fund: The funds set aside for the ongoing maintenance, renewal and replacement of existing costs of capital infrastructure, such as the renovations of a town facilities or road reconstruction.

Borrowing By-law: This by-law authorizes the municipality to proceed with the acquisition of a specified amount of debt subject to defined terms and conditions. Debt cannot be sought without a borrowing by-law.

Capital Financing: A generic term for the financing of capital assets using debt.

Construction Financing: A form of debt financing in which the issuer does not pay any principal and/or interest for a period as defined by the terms of agreement.

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

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 by Infrastructure Ontario are also considered as debt.

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

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

Internal Borrowing: Borrowing of funds between various accounts.

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

Long-Term Debt: Any debt for which the repayment of any portion of the principal is due beyond five years.

Own-Source Revenue: Revenue for the fiscal year such as tax levy, user rates and user fees but exclude:

a) Grants
b) Proceeds from the sale of property
c) Contributions or net transfers from a Reserve Fund or Reserve

Project Financing: the term is used when debt is used to finance a project.

Reserve Fund: means a fund that is segregated and restricted to meet a specific purpose. Monies set aside for a Reserve Fund(s) must be deposited into a separate general ledger account and the interest earned on those investments must be added to the Reserve Fund(s).

Short-Term Debt: Any debt for which the repayment of all the principal is due within one to five years.

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

The Town: Refers to the Corporation of the Town of Aurora.

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

Policy

Council may, where it is deemed to be in the best interest of its taxpayers, approve the issuance of debt for the Town's municipal business. Issuing debt provides the flexibility to proceed with planned capital projects sooner than waiting to collect the funding source for the project in a reserve. Debt issuance should be viewed in combination with long-term capital planning and reserve management as outlined in the Town's fiscal strategy.

The purpose of the debt management policy is to ensure that the Town should continue to manage debt well and stay within the provincial regulations for how much debt a municipality should issue now and in the future.

The objectives of the debt management policy are outlined below:

Adherence to Legislative Requirements

Debt issuance at the Town will only be undertaken in compliance with the provision of the *Municipal Act, 2001*, specifically Part XIII – Debt and Investment, as well as Ontario

Regulation 403/02 (Debt and Financial Obligation Limits); Ontario Regulation 278/02 (Construction Financing); and Ontario Regulation 653/05 (Debt-Related Financial Instruments and Financial Agreements) filed under the Act and as amended.

Debentures cannot be issued to finance current operations. The use of money received can be applied only for the purposes which the debentures were issued or for repayment of outstanding temporary borrowing.

Requirements include but are not limited to the following:

1. The term of the capital financing will not exceed the lesser of 40 years or the useful life of the underlying asset
2. Long-term debt will only be issued for capital projects
3. The term of temporary or short-term debt for operating purposes will not exceed the current fiscal year
4. 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 in relation to other methods of financing

In accordance with the Act where there is a two-tier government structure, debt must be issued by the upper tier. Therefore, all external debt is issued by The Regional Municipality of York ("York Region") on the Town's behalf. The Town is responsible for budgeting the annual debt repayment obligations, transferring the debt payment to York Region, and managing the proceeds of the debentures. The Town's Council must pass a borrowing by-law to initiate the acquisition of external debt through its upper tier municipality.

The Town may also issue debt directly through Infrastructure Ontario, a crown agency of the Province of Ontario, with approval of Aurora's Council and York Region's Council. However, the debt must still be in York Region's name as they ultimately make the debenture payments and reimburse Infrastructure Ontario for the debt payments.

A borrowing by-law must be approved prior to the upper tier municipality acquiring any debt on the Town's behalf.

Long-Term Debt Financing for Eligible Capital Works

Debt financing is a useful tool, careful consideration should be given to when debt should be used and when it should not be. The debt charges for the long-term debt financing are to be funded from the same source(s) as the original funding source(s) of the capital project, i.e., if the capital project was originally to be funded from development charges in the capital budget, any associated debt financing charges would be funded from the development charge revenue in the operating budget.

Debt Financing Consideration Guidelines

Staff should use the following guidelines when considering debt financing for various asset categories:

Asset Management (Repair & Replacement)

Debt should not be used, except for in instances when there is an incremental revenue source, or savings, resulting from the capital investment which will fully fund the resultant debt financing repayment. I.e., Asset management project costs fully funded by user fee revenues. In most scenarios asset management requirements should only be funded through existing cash reserves or grants.

Growth Management

Debt could be considered when the asset is built in advance of growth. When making investments in municipal infrastructure there are often times when a significant investment is made in advance of the growth it is planned to serve. Development charges that are used to pay for many growth projects including recreational facilities (indoor and outdoor), fire, library, water, wastewater and roads. However, these development charge revenues are collected over an extended period as the new developments are built. If the Town were to wait for the collection of these revenues prior to the installation of growth infrastructure, these necessary services will not be available in time for the arrival of the new growth. Issuing debt can be helpful in managing the timing difference between when the project is built and when the revenues are received.

Master, Strategic Plans and Studies

Debt financing shall not be used to fund the creation of studies and plans. Plans and studies identify future capital and operating projects to support the community. While some of the projects that are recommended in the study or plan may need to consider debt financing, the plan or study itself shall not be funded from debt.

Qualifying Criteria for the use of Debt

New debt financing acquisition shall be limited to:

1. New infrastructure requirements
2. Capital programs/facilities which are self-supporting, or financed by a dedicated revenue stream or expenditures savings
3. Projects where the cost of deferring expenditures exceed debt servicing costs
4. Projects which are intergenerational in nature (i.e., large projects with long-term benefits to future generations and who will paying for the debt through their property taxes)
5. Apart from land, the estimated useful life of the asset is greater than five years

6. The project has been approved by Council as part of the capital budget (or other finance document/report) which includes approved debt financing authority.

Ensure Long-Term Financial Flexibility and Sustainability

Debt financing is a useful tool, careful consideration should be given to when debt should be used. Debt financing can support intergenerational equity by aligning the debt repayment with the timing of new growth coming into the community that will benefit from it.

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

To the extent practicable, regular and/or ongoing capital expenditures and the current portion of future asset management costs will be recovered on a "pay-as-you-go" basis through rates, tax levy, user fees and/or reserve fund monies. Adequate reserves must be developed and maintained for all capital assets owned by the Town to ensure long-term financial flexibility. However, where long-term debt financing is required, due consideration will be given to all forms of debt financing including debentures, construction financing, and lease financing agreements.

Aurora debt repayment limit and framework for debt management

The Annual Repayment Limit legislated by the province reflects a significant portion of The Town's revenues including development charges which are excluded from the calculation. Issuing debt to the level prescribed by the province is not sustainable. This policy sets The Town's limit at 10% of own-source revenues. Within this limit, debt will be managed in a manner consistent with the Town's long-term planning, financial and management objectives as follows:

1. To monitor and control the impact of debt servicing costs on the approved annual budget of any given year, and in consideration of the impact on future ratepayers, the annual approved capital budget will demonstrate a balanced approach amongst all forms of funding and external debt financing. Annual debt charges will be the priority draw on available capital funding (development charge or tax funding as appropriate) each year.

2. For development charge funded debt, a minimum balance of one-year's principal and interest costs shall be maintained in development charge reserves with interfund borrowing between development charge reserves permitted. This is to minimize the risk of a downturn in annual development charge collections.

3. New debt which will be funded by development charge funds shall not be acquired if the consolidated development charge reserve balance is negative.

4. When the debt is fully repaid on an asset (excluding development charge funded debt), the debt servicing cost in the operating should be converted to an asset management reserve contribution to support future asset management needs.

Limit Financial Risk Exposure

The capital debt financing program will be managed in a manner to limit, where practicable, financial risk exposure. As a result, long-term debt will only be acquired with an interest rate that will be fixed over its term. Whereas variable interest rates can be considered only for short-term debt.

Capital financing leases have different financial and other risks than traditional debt that must be considered and, where practicable, mitigated prior to its use. For example, contingent payment obligations for items such as, lease termination provisions, equipment loss, equipment replacement options, guarantees and indemnities.

Minimization of the Long-Term Cost of Financing

The timing, type and term of debt financing for an approved capital project will be determined to minimize the Town's overall long-term cost of financing. Typically, shorter term (less than five years) debt financing interest rates are lower than longer term interest rates.

To minimize interest costs over time:

1. Construction financing methods will be considered in accordance with Section 405 of the Act. In advance of the issuance of debentures, shorter term temporary borrowing for capital projects is allowed. The use of rolling short-term financing may be used for a debenture approved capital project.
2. Cost reduction factors which influence the timing and type of debt to be considered include:
   a) Timing of costs and revenues related to a project and any offsetting cost savings attributable to a project
   b) The optimal usage of overall town cash
   c) Capital reserve fund levels, over minimum balances, and the availability of surplus
   d) Reserve fund monies

Suitable and Authorized Debt Financing Instruments

Short-Term – One Year to Five Years

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

1) **Reserves and reserve funds** may be used as the primary source of short-term financing provided that interest is paid at the prevailing market rate. 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. However, reserves and reserve funds are for a defined purpose and must be available when that purpose occurs or requires them.
2) **Infrastructure Ontario** (or its successor organizations) short-term advances pending issuance of long-term debentures.
3) **Construction financing**
   May be used for a period up to five 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.

Long-Term – Greater than Five Years

Debt financing of assets for a period of greater than five years may be from any of the following sources:

1. **Debentures** (including those issued to IO or its successor organizations), which may be in the following form or a combination thereof:
   - Installment Debenture
   - Term Debenture
   - Amortizing Debenture

2. **Lease Financing Agreements** (capital financing leases)
   May be used when it provides material and measurable benefits compared with other forms of financing.

3. **Long-Term Bank Loans** (Variable or floating rate)
   These may be used if deemed cost effective or otherwise necessary.

Financial Guarantees and Letters of Credit

Financial guarantees and/or letters of credit provided by the Town, will be considered as debt, and will be governed by this policy.

Notice Period

The Town recognizes that, to ensure orderly placement of a debenture issue within capital markets, York Region requires a lengthy notice period prior to the issuance. A minimum of four to five months notice is required by York Region, excluding the time required for local Council to approve a borrowing by-law. However, York Region typically sends out an email communication twice a year to survey for any debenture requirements as York Region typically issues debentures twice per year. This advanced notice also allows York Region to work with the Town to ensure that the appropriate borrowing by-law is obtained ahead of a scheduled debt issuance.

Allocation of Excess Debt Financing to Capital Projects

Any arising capital project excess debt financing can be used in three ways, noted in order of priority:

1. Apply excess debt financing to another debt eligible capital project in addition to the already approved debt authority;
2. Reduce Future Debt: Apply excess debt authority to a future debt eligible project to replace part of the already approved debt authority, therefore reducing overall debt financing required;
3. Reduce Debt Charges: use excess debt financing to reduce Debt charges.

Reporting

The Treasurer and Manager, Financial Management will provide an annual report to the Council on the status of Town's debt. Long-Term debt will be reaffirmed by Council as part of the annual budget process.

Responsibilities

All Staff

To adhere to the debt management policy and its associated guidelines.

Finance

The Treasurer will have the overall responsibility for the capital financing program of the Town. The Manager, Financial Management normally will have responsibility for directing/implementing the activities of the capital financing program and the establishment of procedures consistent with this policy.

The Treasurer and the Financial Management division is responsible for developing recommendations and appropriate advice to Council on debt financing decisions and administer any approved debt financing in conjunction with York Region.

Council

Council will have the authority to approve any new debt and the accompanying by-law for the Town.

Monitoring and Compliance

The implementation of the debt management policy principles in acquiring new debt should be monitored through the annual report to the Council and at the time when a new debt authority for capital financing is approved. The debt management policy should ensure that the Town's fiscal impact year-over-year is manageable and is well below the Town's self-prescribed annual repayment limit.

References/Codes

- https://www.ontario.ca/laws/regulation/R02403
- https://www.ontario.ca/laws/regulation/R05653
- https://www.aurora.ca/en/your-government/resources/budget-and-finances/Fiscal-Strategy---Approved-June-22-2021.pdf
- https://www.aurora.ca/en/your-government/resources/budget-and-finances/Town-of-Aurora-2nd-Generation-AMP---Final.pdf

Review Timeline

This policy will be reviewed 2 years after the initial approval date by the Treasurer. If the Treasurer recommends changes to the policy, they will be brought forward to Council for approval.