

Municipality of South Huron Policy



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1. Policy Statement

The efficient and effective use of debt is recognized as an important component in the acquisition and deployment of critical infrastructure requirements that support existing and future residents, businesses and stakeholders of the Municipality. Affordability, sustainability and vulnerability factors must be considered while maintaining a degree of flexibility to address emerging financial needs.

2. Purpose

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

3. Legislative Authority

The Municipal Act, 2001, S.O., c.25, as amended, specifically Part XIII, *Sections 401-424 of the act sets out the authority for a municipality to incur a debt, issue debentures or invest in securities and the limitations and processes involved in doing so.*

4. Definitions

Annual Debt Repayment Limit - means the annual debt and financial obligation limit for municipalities as described under Ontario Regulation 403/02. The regulation provides a formula which limits annual debt service costs to an amount equal to 25% of own source revenue.

Capital Expenditures - means expenditures incurred to acquire, develop, renovate or replace capital assets as defined by the Public Sector Accounting Board, section 3150.

Capital Financing - a generic term for the financing of capital assets using debt, financing leases, or other derivatives.

Construction Financing - a form of debt financing in which the issue does not pay any principal or interest during the construction or rehabilitation of the asset for which debt will be incurred.

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 leases and loans from reserve.

Debt Service Cost - means debt repayments, including interest and principal payments.

Equipment – defined as an apparatus, tool, device, machine, implement or instrument utilized to facilitate a process, function or completion of a task. Equipment also includes furniture and fixtures. It may be installed within a building but could be moved and reinstalled at a different location, if required (it is not permanently affixed to or integrated into the building or structure in which it resides).

Infrastructure - means large-scale public systems, services and facilities of the Municipality that are necessary for economic activity in the community, including water and wastewater systems, roads, and buildings/facilities.

Infrastructure Ontario, or successor organization - any entity established by the Province of Ontario to provide Ontario municipalities, universities and hospitals with access to alternative finance service for longer-term fixed rate loans for the building and renewal of public infrastructure.

Financing Lease – means a lease allowing for the provision of municipal capital facilities if the lease may or will require payment by the municipality beyond the term for which the municipal council was elected.

Municipal capital facilities – include land, works, equipment, machinery and related systems and infrastructures.

Municipality is the Municipality of South Huron

Own source revenues – equal to “net revenues” per Financial Information Return (FIR). The calculation of net revenues is basically total municipal revenues less revenues from Federal & Provincial grants, gas tax, development charges, parkland dedication and donated tangible capital assets.

Rolling Stock – is a means of transportation, usually having wheels, for transporting persons or things or designed to be towed behind such an apparatus, excluding fire trucks.

5. 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.

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

6. Primary Objective of the Capital Financing and Debt Program

The primary objectives for the Municipality’s capital financing and debt program shall be:

- i) Adhere to statutory requirements;
- ii) Ensure long term financial flexibility;
- iii) Limit financial risk exposure;
- iv) Minimize long-term cost of financing; and

6.1. 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 the applicable regulations thereunder, as amended from time to time. These requirements include, but are not limited to:

- i) The term of temporary or short-term debt for operating purposes will not exceed the current fiscal year;
- ii) The term of capital financing will not exceed the lesser of 40 years or the useful life of the underlying asset;
- iii) Long-term debt will only be issued for capital projects;

- iv) The total annual financing charges cannot exceed the Annual Repayment Limit, as applicable, unless approved by the Ontario Municipal Board.
- v) Prior to entering into a lease financing agreement, the Treasurer shall prepare a report assessing the costs and financial and other risks associated with the proposed financing lease as defined in Appendix C to the Procurement Policy.
- vi) 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.
- vii) The awarding of any contract under this Policy will, unless otherwise authorized by Council, follow the procedures and authorities set out in the Municipality's Procurement Policy.

6.2. 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 of assets as well as regular or ongoing capital expenditures (for example annual replacement of fire protective gear) will be recovered on a "pay as you go" basis through rates, tax levy, user fees or reserves and reserve funds.

It is recognized that reserves must be developed and maintained, as outlined in the Municipality's Reserve and Reserve Fund Policy, for all capital assets owned by the Municipality to ensure long-term financial flexibility.

6.3. Limit Financial Exposure

The capital financing program will be managed in a manner to limit, where practicable, exposure to interest rate risk, foreign currency risk, and any other financial risks which may arise from the debt financing.

The Municipality will only issue debt that is denominated in Canadian dollars with an interest rate that will be fixed over its term.

If there is a material financial advantage and/or it is deemed prudent for the Municipality to issue variable rate debentures or enter into variable interest rate bank loan agreements, the interest rate can be left variable if in the opinion of the Director of Financial Services/Treasurer and Council approves, it is in the Municipality's best interest.

Financing leases have different financial and other risks than traditional debt. These risks may include contingent payment obligations, lease termination provisions, equipment loss, equipment replacement options, guarantees and indemnities. These risks will be identified prior to entering into any material financing lease.

6.4. 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 Municipality's overall long-term cost of financing. Factors to be considered include the following;

- a) Current versus future interest rates;
- b) Availability of related reserve or reserve fund monies;
- c) Pattern of anticipated revenues or cost savings attributable to the project or purpose;
- d) All costs related to the financing of the project whether by debenture, construction financing or lease financing agreement.
- e) Variable interest rate debentures
- f) Variable interest rate bank loan agreements

7. Limitations on Indebtedness

Debt limits will preserve borrowing capacity for future capital assets while maintaining maximum flexibility of current operating funds.

7.1. Statutory Limitations

Annual Repayment Limit (ARL)

The Municipality is not allowed, under Provincial regulation to issue debt which would result in the annual repayment limit being exceeded without OMB approval.

Term Restriction

The Municipal Act indicates that the term of the debt will be limited to the useful life of the particular asset but no instances of more than 40 years.

7.2. Self Imposed Limitations

Notwithstanding the limits prescribed in the regulations, prudent financial management calls for more stringent criteria to limit debt.

The Municipality's maximum annual debt servicing limit will be 12.5% with the intention of reducing the maximum debt servicing limit to 10% by the year 2030.

Recognizing that there is a significant cost, both in issuing debt as well as the annual interest cost associated with borrowing funds, the Municipality will not issue debt for an amount less than \$1,000,000.00. The Municipality will not issue long-term debt to finance for rolling stock (excluding fire trucks) and/or equipment, these purchases are to be funded through the use of tax levy, user fees or reserves. Leases of rolling stock shall be permitted where feasible and where the overall cost to the taxpayer will be lower than if the vehicle was purchased.

7.3. Term Restriction

The Municipality's term of debt will not exceed the lesser of (i) the expected useful life of the capital investment and (ii) 30 years.

8. Debt Retirement

Upon retirement of the long-term debt, the annual budgeted principal and interest amount funded will be allocated to the infrastructure capital plan for the original funded source (ie levy or user fee). This amount will not reduce the total base capital expenditure for that fiscal year.

9. Ethics and Conflicts of Interest

Officers and employees involved in the capital financing process are expected to abide by the Municipality'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 Municipality.

10. Types of Debt

10.1. Short-Term Debt (under one 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 the following sources;

- a) Reserves and reserve funds (provided amount is repaid with interest)
- b) Bank line of credit
- c) Infrastructure Ontario (or successor organization) short-term advances (known as construction advances) pending issuance of long-term debentures. Construction financing may be used for a period up to two (2) years during construction

10.2. Medium-term Debt (one to less than five years)

The Municipality may use medium-term debts financing from one of the following sources;

- a) Reserves and reserve funds (provided amount is repaid with interest)
- b) Operating or capital leases (provided that analysis is conducted per Appendix C of the Municipality's Procurement Policy)
- c) Term loans with any Canadian bank

10.3. Long-term Debt (five years or greater)

Financing of assets for a period of greater than five years may be from any of the following sources;

- a) Serial or amortized debentures
- b) Term loans with any Canadian bank
- c) Capital Financing Leases – may be used when it provides material and measurable benefits compared with other forms of financing.

10.4. Internal borrowing from Reserves and Reserve Funds

When an analysis of the reserve or reserve fund has determined that excess funds are available and that the use of these funds will not adversely affect the intended purpose of the reserve or reserve fund, the Municipality's reserves may be used as a source of financing for short to medium term purposes.

The reserves will be repaid with interest at a rate based on the rate which the Municipality's bank account receives (i.e. Prime minus 1.75%)

Each such loan is to be authorized by a specific by-law passed by Council and define the amount, interest rate, term of the loan and the specific reserve or reserve fund from which the loan is made.

11. Delegation of Authority

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

The Financial Services Director/Treasurer shall in addition;

- a) Calculate the Financial Obligation Limit (Updated ARL) for the Municipality as prescribed by the Municipal Act;
- b) Approves the timing and structure of debt issues;
- c) Coordinates the preparation of debt issue bylaws for Council;
- d) May execute and sign documents on behalf of the Municipality and perform all other related acts with respect to the issuance of debt securities;
- e) Review and recommend to Council the financial and business aspects of any material lease agreements and transactions; and
- f) Ensure all legislative reporting requirements are met.

12. Requirement for External Advice

The Municipality's staff will be expected to have sufficient knowledge to prudently evaluate standard financial transactions. However, should in their opinion the appropriate level of knowledge does not exist for unusual or non-standard transactions, or otherwise directed by Council, outside financial and/or legal advice will be obtained.

13. Policy Review

The Treasurer shall undertake periodic reviews of this policy and is authorized to make administrative amendments to the policy. Any administrative amendments authorized by the Treasurer shall be clearly identified and added as an appendix to this policy. The policy will be reviewed during the term of each new Council to ensure that the objectives are consistent with and continue to address the needs and vision of the Community.