COUNTY OF WELLINGTON
POLICY & PROCEDURE MANUAL

DEPARTMENT	TREASURY	**POLICY NUMBER**	TR-21-04
SECTION	FINANCIAL SERVICES	**EFFECTIVE DATE**	NOVEMBER 1, 2021
SUBJECT	**DEBT MANAGEMENT POLICY**		
AUTHORITY	PENDING COUNTY COUNCIL APPROVAL ON OCTOBER 28, 2021		

PURPOSE:

1. To preserve and improve the long term financial health of the Corporation.

2. To establish the principles governing the financing of the County's long term infrastructure and facility requirements.

3. To establish the process for evaluating potential lease financing arrangements and reporting the results to Council under the *Municipal Act, 2001* and Ontario Regulation 266/02.

4. To provide guidance to staff when contemplating lease arrangements for the provision of municipal equipment and facilities.

5. To ensure that both staff and Council are aware of the entire cost of the financial lease, of any specific risks to the County that are attached to the lease agreement and that alternative sources of financing have been considered.

STATEMENTS:

LONG-TERM FINANCING AND DEBT MANAGEMENT

Philosophy for Capital Financing and Debt Issuance

1. The first and guiding principle with respect to capital budget financing is to adopt a "pay-as-you-go" approach, and therefore to minimize the issuance of debentures or other forms of long term financing. The benefits of this approach are as follows:
   - The financial consequences of capital spending are faced as spending decisions are being made
   - Paying for capital costs up-front encourages a realistic level of spending
   - Greater operating budget flexibility is preserved for the future, in that there is no appropriation of current tax revenues simply to finance interest and principal payments on previously issued debt
   - Increased corporate financial strength
   - Future generations inherit paid-up facilities
   - Interest payments, fiscal agent fees, and debenture issuance costs avoided

2. 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.

3. 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.

Development of Capital Budget Financing

1. The County will seek to maximize the use of grants and subsidies from senior levels of government, as well any other possible sources of external capital financing

2. Development Charges are used as a source of financing for growth-related capital works in accordance with the current Development Charges Background Study, the County's current Development Charges By-Law, and the Development Charges Act

3. Wherever possible, the net County share of capital works will be funded through current year appropriations from the tax levy

4. The County will use its capital reserves as required in order to finance capital works and to limit large fluctuations in tax levy funding for capital works – through the County's reserve and reserve fund policy, funds will be set aside on an annual basis from the operating budget in order to accumulate reserves which are sufficient to fund large capital works, subject to annual budget approval

5. Long-term debt will not be used to finance current operations

6. Long-term debt will only be used for capital expenditures that are identified in the ten-year plan and for emergency capital expenditures as approved by Council resolution.

7. Debenture or long-term financing is restricted to the following cases:
   - The capital project value exceeds $1 million for tax supported debt
   - Any amount as deemed necessary by County Council to fund growth related capital projects in advance of development charge collections
   - The overall debenture issue will exceed $1 million
   - The estimated useful life of the asset is greater than ten years
   - The debenturing of a mortgage for an affordable housing project owned directly by the County or the Wellington Housing Corporation
   - Emergency expenditures for which there is no immediately available source of financing
   - Funding cannot be accommodated within the tax levy, use of reserves or reserve funds and external funding sources have been thoroughly investigated

LEASE FINANCING PROCEDURES

Prior to entering into a material lease, the County Treasurer must prepare a report to Wellington County Council that:

- Evaluates the financial costs of the lease; and
- Evaluates the potential risks of the lease

Evaluating a Financing Lease Agreement

- Before entering into a lease, a report will be presented to Council that clearly identifies the following:
    - A comparison of the lease costs of the proposed lease and other methods of financing (debt, reserves, operating funds);
    - A calculation of the effective rate(s) of interest for the lease financing;
    - A sensitivity analysis of leases with variable lease payments;
    - A schedule of all fixed amounts of payment
    - A statement of any contingent payment options associated with termination, replacement, loss, guarantees and indemnities;
    - An opinion on whether or not the costs of the financing lease agreement are lower than other methods of financing available to the County; and
    - An opinion on whether the risks associated with the financing lease are reasonable.
- The report shall include legal advice on the provisions of the proposed financing lease agreement to ensure that all of the risks of the lease have been adequately disclosed to the Treasurer and County Council.
- The costs and risks associated with a proposed financing lease in the report shall be assessed as of the date the report is made. The summary of information in the report shall include all information required for the entire term of the lease, including any possible extensions or renewals.
- At any time after a report regarding a potential financing lease agreement has been made, but before the financing lease is entered into, if the County Treasurer becomes of the opinion that a changed circumstance with respect to the proposed lease may result in a material impact for the County, the Treasurer shall as soon as reasonably possible update the report and present the updated report to County Council.

Annual Reporting Requirements

- Annually, the County Treasurer is required to report on all leases to Council in addition to the reporting requirements for the new lease financing agreements. This report will be submitted to Council in January and cover all leases in effect as of December 31st the previous year. The report shall include:
    1. A description of the estimated proportion of the total financing arrangements of the County that is undertaken through financing leases tot eh total long-term debt of the County and a description of the change, if any, in that estimated proportion since the previous year's report;
    2. A statement by the County Treasurer as to whether, in his/her opinion, all financing leases were made in accordance with this Lease Financing Policy; and
    3. Any other information that County Council may require or that, in the opinion of the County Treasurer, should be recorded.

Exemptions for Non-Material Leases

- A financing lease agreement is exempt from the requirements of this policy if it is considered not to have a material impact on the finances of the County. The following leases are considered non-material leases:
    1. Rental agreements that have a term of less than one year and the cancellation of which results in no financial penalty to the County.
    2. Commercial real property leases (e.g. libraries) with a term of five years or less.
    3. An operating lease that has a present value of $125,000 or less.
    4. A capital lease that has a present value of $250,000 or less.

- Before entering into a non-material financing lease, the County Treasurer will prepare a report for County Council that expresses the opinion that the proposed lease is exempt from the Lease Financing Policy and that its costs and risks would not result in a material impact, as defined in this policy. This includes an assessment of all non-material leases to ensure that when they are entered into or proposed to be entered into, do not result in a combined material impact for the County.

Local Municipal Notification

- The seven local municipalities located within the County of Wellington are required to notify the County of material leases that they plan to enter into. Long-term material leases form part of the debt repayment calculation as performed by the Province and could have an impact on the County and local municipal credit rating.

DEBT MANAGEMENT PROCEDURES

Debt Limits

1. Statutory Limitations – Annual Repayment Limit (ARL)

- Ontario Regulation 403/02 of the Municipal Act, 2001 sets out the annual debt and financial obligation limits for municipalities. The regulation provides a formula which limits annual debt service costs to an amount equal to 25% of operating revenue. The County is not allowed under this regulation to issue debt which would result in the annual repayment limit being exceeded without Ontario Municipal Board (OMB) approval.

2. Self-Imposed Limitations

- Notwithstanding the limits prescribed in the regulations, prudent financial management calls for more stringent criteria to limit debt. These criteria will assist in preserving borrowing capacity for future capital assets while maintaining maximum flexibility for current operating funds.
    - **Tax-Supported Debt to Operating Revenue:**
      This measure identifies the percentage of annual operating revenues that would be required to retire the County’s net debt. It is also used by Standard and Poor’s when assessing the debt burden of a municipality. A target rate of less than 30% should be maintained.
    - **Interest Payment to Adjusted Operating Revenues:**
      This ratio is a measure of the interest payable annually as a proportion of adjusted operating revenues (excludes non-cash items). It should not exceed a target of 5%.
    - **Direct Debt to Reserve Ratio:**
      This ratio compares direct debt to the total of all reserves and reserve funds. A generally accepted target ratio for municipalities is considered to be no more than 1:1. The County should maintain a ratio below 0.75:1.

Debt Structuring Practices

1. The repayment term will be dependent on the useful life of the asset being acquired by the County, but should not exceed 10 years except for major capital construction of public infrastructure. Longer term financing will be evaluated with respect to capital market conditions, nature of the project, and long-term infrastructure needs as considered appropriate by the County Treasurer.
   - Debt shall be structured for the shortest period consistent with a fair allocation of costs to current and future users.
   - Debt shall be structured to achieve the lowest possible net cost to the County given market conditions, the type of debt being issued, and the nature and type of the repayment source.
   - Unless otherwise justified and deemed necessary by the County's fiscal agent, the repayment schedule should be structured on a level of declining payment basis.
   - Early repayment of debt may be considered if it's financially beneficial to do so.

2. Terms and Types of Debt
   - Short-term Debt (under one year):
     The County may use either of the following sources to fund short-term operation needs:
     1. Bank line of credit
     2. Operating lease
   - Medium-term Debt (one to nine years):
     The County may use any of the following sources to fund medium-term needs:
     1. Operating and capital leases
     2. Term Loans
     3. Promissory notes
   - Long-term Debt (10 years or longer):
     The County may use any of the following sources to fund long-term needs:
     1. Municipal serial or amortized debentures
     2. Loans through Infrastructure Ontario (or successor organization)
     3. Term loans / mortgages with any Canadian bank
     4. Capital leases

3. The capital financing programme will be managed in a manner to limit, wherever practicable, financial risk exposure including currency risk and interest rate risk. The County shall only issue debt denominated in Canadian dollars with an interest rate that will be fixed over its term.

Debt Issuance Practices

1. The approval to fund an eligible capital project by debenture will generally be sought through the annual capital budget process.

2. Each debenture shall be approved by specific by-law of Council including the term, rates of interest, debt servicing obligation, and general terms of issue.

3. The County will engage the services of a Fiscal Agent to develop the debt issuance strategy, determine the interest rate ad method of calculating the interest rate, and to market bonds to investors.

4. For all debt issues, the County will retain external legal counsel who will assist with the drafting and reviewing of the debt issue by-law and related schedules.

5. When feasible, debt issuances will be pooled to minimize insurance costs.

6. The County will continually strive to maintain or improve its current AA+ credit rating by adhering to sound financial management practices. This practice will ensure the long-term financial health of the County so that its borrowing costs are minimized and its access to credit is preserved. Standard and Poor's (S&P) is the County's debt rating agency. County staff will carry out a review with S&P officials annually to provide updates on information affecting the County's credit position and to obtain an updated credit rating.

DEFINITIONS:

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

Capital Lease: a financing lease that is for the acquisition of a capital asset and meets one or more of the following criteria, which classifies it as a purchase by the County:

- The lease term is greater than 75% of the property's estimated economic life;
- The lease contains an option to purchase the property for less than fair market value;
- Ownership of the property is transferred to the County at the end of the lease term;
- The present value of the lease payments exceeds 90% of the fair market value of the property

Credit Rating: is an independent opinion of an issuer's financial capacity to meet its debt payment obligations. A credit rating is not an audit of an issuer, nor is the rating agency acting as a financial advisor. The investment community uses credit ratings in order to differentiate credit quality when considering various investment options. Generally speaking, the higher the credit rating, the lower the credit risk to investors and the lower interest rate the County will need to pay on debt issued.

Combined Material Impact: means the cost or risks of a proposed non-material lease, which, when combined with all other non-material leases entered into or proposed to be entered into in a particular year by the municipality, would result in a material impact.

Currency Risk: is the potential risk of loss from fluctuating foreign exchange rates when a borrower has exposure to foreign currency or in foreign currency-denominated debt.

Debenture: A written promise to pay a specified sum of money called the face value or principal amount at a specified date or dates in the future, called maturity dates, together with periodic interest at a specified rate. Debentures are purchased by the investment community and are used as a source of long term financing for municipal capital works, in return for interest and principal payments.

Financial Flexibility: The ability to issue debt responsibly without impacting the credit rating or ability to generate required revenues. It is the ability to change debt or tax levels to meet the County's obligations.

Financial Sustainability: The ability to provide and maintain service and infrastructure levels without resorting to unplanned increases in rates or cuts to service. It is the ability to meet present needs without compromising the ability to meet future needs.

Financing Lease: is a lease allowing for the provision of municipal capital facilities if the lease may or will require payment by the County beyond the term for which Council was elected.

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

Interest Rate Risk: is the risk that arises from fluctuating interest rates. Interest rate risk on a debt instrument will depend on how sensitive it is to interest rate changes in the market.

Material Impact: means costs or risks that significantly affect, or would reasonably be expected to have a significant effect on, the debt and financial obligation limit prescribed under Ontario Regulation 403/02

Material Lease: is a financing lease that would result in a material impact for the County.

Municipal Capital Facilities: include land, as defined in the Assessment Act, works, equipment, machinery and related systems and infrastructures as defined in Section 110 of the Municipal Act.

Operating Lease: a financing lease for the acquisition of an operating item or for which the County acquires the property for only a small portion of its useful life. An operating lease is commonly used to acquire equipment on a short-term basis. Any lease that is not a capital lease is an operating lease.

Operating Revenue: are recurring revenues that are received by the County. Operating revenues comprise of property taxes and non-tax revenues, such as grants, operating subsidies, fines, user fees and rents. It excludes capital revenues, such as capital subsidies and proceeds from asset sales and any revenue from borrowed funds.

- Formula:
  Total consolidated statement of operations revenues (per FIR 10-9910) less Ontario grants for general assistance (12-1210-1), less provincial and federal grants and other municipal contributions for tangible capital assets (10-0815, 10-0825 and 10-1098), less gain/loss on sale of land and capital assets (10-1811), less development charges earned (10-1812), less federal gas tax earned (10-0831) and less donations revenue and donated capital assets (10-1830 and 10-1831). To be updated from time-to-time as required by Standard and Poor’s.

Pay-As-You-Go: Used to describe a financial policy whereby capital outlays are financed from current revenues and/or reserves rather than by debt.

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

Tax-Supported Debt: The total debt burden of the County (per FIR 74-9910). It includes all debt issued by the County and consolidated entities net of on-lent debt to the County’s self-supporting member municipalities.

OTHER RELATED POLICIES:

- Budget Management Policy
- Purchasing Policy