CORPORATE POLICY and PROCEDURE	WOOLWICH TOWNSHIP	Policy No.: FI-11 Pages: 11 Effective Date: December 17, 2024 supersedes: None.

SECTION: Finance

SUBJECT: Debt Management Policy

POLICY SCOPE

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

POLICY STATEMENT

It is the policy of The Corporation of the Township of Woolwich ("the Township") to

- Ensure adequate infrastructure, services and resources to support existing and growing communities.
- Ensure new debt is planned at a level which will optimize borrowing costs and not impair the financial position of the Township.
- Ensure debt is structured in a way that is fair and equitable to those who pay for and benefit from the underlying assets over time.

POLICY OBJECTIVES

Council may, where it is deemed to be in the best interest of its taxpayers, approve the issuance of debt for the Township's municipal business. Debt issuance should adhere to the pillars in the Township's long term financial framework and to applicable legislation.

The key objectives of the Debt Management policy include:

1. **Adherence to legislative requirements:** Debt issuance will be undertaken in compliance with the provision of the *Municipal Act, 2001* and other legislative requirements.
2. **Ensure fiscal sustainability:** Debt will be issued responsibly ensuring the Township's long-term financial sustainability and the Township's ability to service the debt while protecting the worthiness of the Region of Waterloo's credit rating.
3. **Ensure fiscal resiliency:** Debt will be issued in consideration of existing reserve and reserve funds to guard against unforeseen events. and establish financial guidelines and appropriate benchmarks for the issuance and use of debt in the Township.

4. **Ensure fiscal responsibility:** Debt will used to match the long-term cost of infrastructure projects to those that receive the benefits and can improve taxpayer affordability and intergenerational equity

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 amountequal to 25% of operating revenue (own-sourced revenue which excludes development charges).

Annual Debt Financing Charges: The estimated amount of operating budget funds, in arespective 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's 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. Debtcannot be sought without a borrowing by-law.

Capital Expenditure: An expenditure incurred to acquire, develop, renovate or replace capital assets as defined by the Public Sector Accounting Board (PSAB), section 3150.

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 anyprincipal and/or interest for a period as defined by the terms of the agreement.

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

Debt: Any obligation for the payment of money. For Ontario municipalities, debt wouldnormally 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.

Development Charge (DC) Collections: Charges collected from new development, at building permit issuance to help fund the cost of infrastructure required to accommodate growth.

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

Direct Debt: Means the total debt burden of the Township (per FIR 74-9910). It includes all debt issued by the Region of Waterloo on behalf of the Township and consolidated entities less all debt assumed by others.

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

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

Internal Funding: Funding provided from one Township reserve fund to another, to fund specific short-term projects. These funds will be repaid from the receiving fund to the lending fund in accordance with a promissory note.

Internal Borrowing: Borrowing of funds between various accounts.

Non-tax Supported Debt: Debt issued for capital expenditures related to non-tax supported operations. This debt is repaid using net revenue fund revenues.

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 currentterm of Council.

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

Operating Revenue: Total revenue fund revenue per line 9910 of FIR schedule 10 less other revenue (10-1899), less grants received (10-0699 and 10-0899), less revenue from other municipalities (10-1099).

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

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

Tax Supported Debt: Debt issued for capital expenditures related to tax supported operations. This debt is repaid using net revenue fund revenues.

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

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.

LEGISLATIVE REQUIREMENTS

Municipal Act

Debt issuance in the Township 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.

Debenture Requirements

Debentures cannot be issued to finance current operations. The use of money received can be applied only for the purposes for 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 borrowing 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.

Upper Tier Government

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 Waterloo ("Waterloo Region") on the Township's behalf. The Township is responsible for budgeting the annual debt repayment obligations, transferring the debt payment to Waterloo Region, and managing the proceeds of the debentures. The Township's Council must pass a borrowing by-law to initiate the acquisition of external debt through its upper tier municipality.

The Township may also issue debt directly through Infrastructure Ontario, a crown agency of the Province of Ontario, with approval of Woolwich Council and Waterloo Region's Council. However, the debt must still be in Waterloo 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 Township's behalf.

DEBT FINANCING CONSIDERATIONS

Overview

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 useful life of infrastructure and those that will benefit from the work.

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 Township 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.

Funding Sources

The debt payments for 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.

Infrastructure Repair and Renewal

Ongoing infrastructure repair and renewal maintenance should generally not be funded by debt. There are a few exceptions.

1. When there is a significant renewal project which will have long term benefits affecting future taxpayers. In these cases, the useful life of the renewal project must be at least 20 years and have a minimum cost of $1 million. This ensures that routine repair and renewal work is not funded by debt.
2. When there is an incremental revenue source, or savings, resulting from the capital investment which will fully fund the debt costs (i.e. LED street light conversion).

Growth Funding Needs

Debt may be considered when the asset is required in advance of growth (for example water and wastewater servicing). There is often a timing difference between when development charges are collected and when the infrastructure is required. Issuing debt can be helpful in managing the timing difference.

For debt issued related to new growth a detailed debt repayment plan must be developed. This includes the anticipated timing for growth to ensure that sufficient development revenue is available to repay this debt over the life of the debenture.

Timing

The borrowing to finance capital projects will normally occur once the projects are essentially completed. Capital projects that require borrowing to cashflow work before substantial completion would be considered construction financing and would not exceed a term of 3- years.

QUALIFYING CRITERIA FOR THE USE OF DEBT

New debt financing acquisition shall be limited to:

1. New infrastructure requirements to support growth before development revenue is received
2. The estimated useful life of the asset is greater than 10 years for growth and 20 years for infrastructure renewal
3. Capital projects with a total cost of at least $1 million. This threshold may extend to a program of similar work that covers a single fiscal year.
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) and achieves a fair allocation of costs between current and future users.
5. Capital programs/facilities which are self-supporting, or financed by a dedicated revenue stream or expenditures savings
6. Projects where the cost of deferring expenditures exceed debt servicing costs.
7. The economic benefits or useful life of the asset exceeds the term of the debt. For example, if the debt term is 10 years, the useful life of the asset must be at least 10 years.
8. The project has been approved by Council as part of the capital budget (or other finance document/report) which includes approved debt financing authority.
9. A sustainable funding source has been identified over the term of the debt.

Funding of the capital expenditure cannot be accommodated within the tax supported capital budgets, rate supported capital budgets, development charge capital budgets, and other internal sources (such as borrowing from reserve funds) and external sources (such as senior government grants and subsidies or user-pay systems) have been thoroughly investigated.

Other Financial Considerations

Other considerations to keep in mind before choosing debt funding include:

1. Total cost of the project
2. The cash flow of the project including debt issuance and repayment terms
3. The operating costs after completion of the project

DEBT REPAYMENT LIMITS AND DEBT MANAGEMENT

Overview

The annual repayment limit (ARL) is set by the province based on the Townships FIR Return. The Township is not permitted under Provincial regulation to issue debt which would result in the annual repayment limitbeing exceeded without OLT approval.

Legislative Maximums

The ARL issued by the province represents 25% of own source revenues without debt charges. This limit is very large and reflects a significant portion of the overall Township revenues. Issuing debt at this level would not be sustainable or responsible. As a result, a more conservative debt limit would be appropriate to maintain.

Township Maximums

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.

The following maximums are grouped into both hard and soft caps. The hard limits are policy maximums that cannot be breached without impacting the financial health of the Township. The soft limits are best practices and are tracked and reported but would not prevent the issue of debt if the ratios are breached upon Council approval. It is still important to be aware that issuing debt in excess of either of these limits represents an increased financial risk.

Hard Limits

Debt to Own Source Revenue

This ratio is a measure of the principal and interest payable annually as a proportion own source revenue. It should not exceed a target of 10% of the total revenues on line 2610 of schedule 81 of the FIR.

Debt to Own Source Revenue (Growth)

The ratio above includes several deductions to arrive at own source revenue including the exclusion of development charges. For debt that is being used to support growth only, development charge revenue can be used to support debt repayments. In this case total debt payments can be up to 15% of line 2610 of schedule 81 of the FIR provided at least 25% of total debt payments are funded by external sources such as development charges.

Development Charge (DC) debt assessment

A feasibility assessment will be used to ensure that each approved DC service that requires debt is able to provide sustainable cash flows and the ability to collect sufficient funds to retire the debt.

Soft Limits

Total Debt to Operating Revenue

This measure identifies the percentage of annual operating revenues that would be required to retire the Township's net debt. It is also the prime measure used by Standard and Poor's when assessing the debt burden of the municipality. A target rate of less than 55% should be maintained.

Debt Servicing to Discretionary Reserve Ratio

This ratio is used to determine how many years the Township could pay for debt servicing obligations in the absence of new revenue.

- A target of 1:14 annual debt costs / discretionary reserves should be maintained.
- A target of 1:1 of total debt outstanding to discretionary reserves should be maintained.
- For DC debt, a target of 1:1 of total debt development charge debt outstanding to development reserves should be maintained.

Debt burden per capita (no longer recommended)

This calculates the total debt burden divided by population.

In 2009 Council set the approved debt per capita a $230. The 2024 level was adjusted to $372 as there had been no adjustment to account for inflation.

Each municipality has different structures with services provided by different levels of government. For example, the Township only funds 31% of municipal services with the majority provided by the Region. Debt per capita does not account for these differences and also does not automatically adjust for inflation the way other measures would. For these reasons, debt per capita is not a recommended measure.

ROLES AND RESPONSIBILITIES

<u>Municipal Council</u>

In accordance with the Municipal Act 2001, Section 224 one of the role of Council is to develop and evaluate policies, ensure that administrative policies, practices and procedures and controllership policies, practices and procedures are in place and maintain the financial integrity of the municipality.

Council's have authority to approve any new debt and the accompanying by-law for the Township. All approval for the use of debt will be made through the annual budget process or by specific Council resolution and/or by-laws.

<u>Municipal Treasurer</u>

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

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

The Treasurer will:

1. determine the source of financing for the Township's programs and capital works
2. manage debt in accordance with legislative requirements and the Township's existing policies
3. develop appropriate strategies, procedures and processes for repayment of debt and for the investment of debt proceeds
4. monitor existing debt levels in line with established policies and requirements
5. Report annually on:
    a. annual principal and interest payments
    b. total outstanding debt
    c. forecasted debt over a 10-year time horizon
    d. debt capacity limits and ratios

DEBT STRUCTURE

Types of Debt

Short Term Debt

Financing operational needs for a period of less than one year pending the receipt of taxes and other revenues, or interim financing of up to three 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 provided it is cost effective or otherwise necessary. However, reserves and reserve funds are for a defined purpose and sufficient funding must be available when that purpose occurs or requires them.
2. **Construction financing** may be used for a period up to three 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.
3. **Short-term borrowing or loans** may be used for a period of no greater than three years or otherwise necessary. The short-term borrowing arrangement will be identified for a specific project, not for operating expenditures, evaluated by the treasurer and presented to Council for approval.

Long Term Debt

Debt financing of assets for a period of greater than three 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 / Serial 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) may be used if deemed cost effective or otherwise necessary.

Repayment Terms

Working capital borrowing to meet short term cash flow obligations. This borrowing must be approved by the Treasurer repaid within twelve months. If the term exceeds twelve months, the arrangement will require further review by the Treasurer and Council requires approval.

Construction financing arrangements or other short-term borrowing may be used for a period of no more than three years. If the term exceeds three years, the arrangement will require further review by the Treasurer and Council requires approval.

Reserve and internal borrowing can be used for a term not exceeding five years. If the term exceeds three years, the arrangement will require further review by the Treasurer and requires Council approval.

Debentures and long-term debt will normally be issued for a term of at least ten years and a term of not more than thirty years. The term of the debenture must be reviewed by the Treasurer and approved by Council and match the term of the debt to the economic benefits of the project.

Fixed vs. Variable Interest

Variable interest is only suitable for short-term borrowing of three years or less. To ensure predictability for budgeting and long-term sustainability, debentures or long term borrowing beyond three years will be issued at a fixed interest rate.

Excess Debt Financing

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

- Apply excess debt financing to another debt eligible capital project in addition to the already approved debt authority
- 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
- Reduce debt charges: use excess debt financing to reduce debt charges

INTERNAL BORROWING

Internal Borrowing Overview

The Township has the power pursuant to section 417 of the Municipal Act, 2001, SO 2001, c. 25 to apply reserve funds to a purpose other than that for which the fund was established. This includes the making of an internal loan from reserve funds in order to finance capital projects or other works.

The municipality may elect to borrow from internal sources using reserve funds, provided that excess funds are available, and the use of these funds will not impact the reserve funds current operations. Internal reserve borrowings will pay a variable interest rate to the lending reserve/reserve fund Borrowing in this manner offers several advantages over traditional debenture financing including the following:

- Increased flexibility in setting loan terms,
- Lower interest cost, and
- Avoidance of legal and fiscal agent fees.

Requirements

For the approval of each internal loan the specific details must, at a minimum, include the following:

- Start date
- Loan type
- Loan amount
- Loan period
- Loan rate

- The loan rate will reflect the Township's all-in cost of funding for a similar term and structure at the time of the actual loan, as determined by the Treasurer
- Repayment frequency
- Legal Documentation

Reserve Fund Borrowing

In compliance with the reserve and reserve fund policy, inter-fund borrowing between reserve and reserve funds is permitted, with the exception of the obligatory reserve funds. Obligatory funds are not permitted to fund deficiencies in the reserves and reserve funds.

Short-term inter-fund borrowing is permitted to cover a reserve or reserve fund shortfall over a period of less than two years where:

- sufficient funding is available
- it is deemed appropriate by the Treasurer; and
- interest is paid annually on the borrowed funds where applicable

Long-term inter-fund borrowing is permitted over a period of greater than two years where:

- sufficient funding is available
- it is deemed appropriate by the Treasurer and,
- interest is paid annually on the borrowed funds
- there is a Council approved By-law

The *Development Charges Act* 1997 permits inter-fund borrowing between DC reserve funds, provided that all amounts borrowed are repaid with a prescribed rate of interest.

POLICY REVIEW

This policy will be reviewed every four years at every change in Council or as needed.

REFERENCES

- https://www.ontario.ca/laws/regulation/R02403
- https://www.ontario.ca/laws/regulation/R05653