



## Staff Report

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<b>Report To:</b>	<b>Audit and Accountability Committee</b>	
<b>Date of Meeting:</b>	June 29, 2021	<b>Report Number:</b> FSD-042-21
<b>Submitted By:</b>	Trevor Pinn, Director of Financial Services/Treasurer	
<b>Reviewed By:</b>	Andrew C. Allison, CAO	<b>By-law Number:</b>
<b>File Number:</b>		<b>Resolution#:</b>
<b>Report Subject:</b>	2021 Financial Policy Updates	

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### Recommendations:

1. That Report FSD-042-21 be received; and
2. That the Debt Management Policy attached to Report FSD-042-21, as attachment #1, be approved.

## Report Overview

As municipalities grow and assets age, debt financing becomes a source of funding for capital infrastructure investment. The use of debt is a tool available to ensure generational equity, those taxpayers benefiting from the use of the asset pay for it. The prudent use of debt is essential for the overall fiscal health and sustainability of a municipality.

The Government Finance Officers Association of Canada and the United States (GFOA) recommends that governments establish a written policy on debt management. This report, and the attached proposed policy, provide a written policy on the use of Debt within Clarington.

## 1. Background

### Legislation on Municipal Debt

- 1.1 Section 401 of the *Municipal Act, 2001* provides that a municipality may incur debt for municipal purposes, whether borrowing money or in any other way, and may issue debentures and prescribed financial instruments and enter into prescribed financial agreements for or about the debt. The section also indicates that a lower-tier municipality in a regional municipality does not have the power to issue debentures (or other forms of long-term debt); however, the upper-tier may do so on their behalf.
- 1.2 As amended, Ontario Regulation 403/02 sets out the debt and financial limitations that a municipality under which they may operate. The prescribed limit is 25 per cent of “own-source revenue” (which has a prescribed form of calculation). This Annual Repayment Limit is the debt servicing costs (debt principal and interest payments) that a municipality may make in a year.
- 1.3 The legislation further restricts the use of debt for expenses to current year borrowing. A municipality cannot use long-term debt to finance operating expenditures; this is different from the Province of Ontario and the Government of Canada, which both can use debt to finance operating expenses or programs.

### Industry Best Practices

- 1.4 The Government Finance Officers’ Association of the United States and Canada (GFOA) issues advice on best practices in financial management. The best practices include the creation of policies for certain financial management areas.
- 1.5 GFOA recommends that state (provincial) and local governments adopt comprehensive written debt management policies. These policies should reflect local, state/provincial, and federal laws and regulations. GFOA recommends that a government’s Debt Management Policy should be reviewed periodically and updated if necessary.

- 1.6 The Municipality of Clarington does not currently have a written debt management policy. Past practice has relied on legislative requirements and responds to the asset management plan and budgetary needs.
- 1.7 Establishing a debt policy provides guidance for future financial planning and budgeting decisions, establishes criteria for debt use, and ensures accountability and transparency to taxpayers.

## 2. Debt Management Policy

- 2.1 Staff considered the GFOA recommendations in developing this Debt Management policy and reviewed existing Ontario municipal policies to establish best practices and regulatory compliance.
- 2.2 The following chart outlines the recommended best practices and how this policy addresses the recommendation.

<b>GFOA Debt Management Policy Recommendation</b>	<b>Municipality of Clarington Proposed Debt Management Policy</b>
<p><b>Debt Limits</b></p> <p>The policy should consider setting specific limits or acceptable ranges for each type of debt. Limits are set for legal, public policy and financial restrictions and planning considerations.</p>	<p>The proposed policy sets the limit of 25 per cent based on the Provincially legislated limit.</p> <p>Further, from a public policy and financial planning perspective, the internally imposed limit is set below the legislative limit at 15 per cent. This provides flexibility for emergencies if the Municipality requires additional debt capacity.</p>
<p><b>Debt Structuring Practices</b></p> <p>The policy should include specific guidelines regarding the debt structuring practices for each type of bond including:</p> <ul style="list-style-type: none"> <li>• Maximum term</li> <li>• Average maturity</li> <li>• Debt service patterns such as equal payments or equal principal amortization</li> </ul>	<p>The proposed policy sets the maximum term at 40 years or the useful life of the asset. A preference for 10 years is identified.</p> <p>To provide for stable debt servicing costs, the policy identifies that debt should be structured with equal payments (amortizing) rather than equal principal (serial)</p> <p>The policy identifies the preference to enter into fixed-rate debentures to reduce</p>

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<ul style="list-style-type: none"> <li>• Use of optional redemption features</li> <li>• Use of variable or fixed-rate debt, credit/liquidity enhancements, derivatives, short-term debt, and limitations as to when and the extent each can be used</li> <li>• Other structuring practices should be considered, such as capitalizing interest during the construction of the project and deferral of principal, or additional internal credit support</li> </ul>	<p>interest rate risk, however the rate may fluctuate throughout the term.</p> <p>The Regional Municipality of Durham is responsible for structuring and issuing debt. Optional redemption features and other structuring practices would be at their discretion. However, it has not been common to see these features in debt issued by the Region.</p>
<p><b>Debt Issuance Practices</b></p> <p>The policy should guide the issuance process, which may differ for each type of debt. These practices include:</p> <ul style="list-style-type: none"> <li>• Selection and use of professional services providers, including an independent advisor</li> <li>• Criteria for determining the sale method (competitive, negotiated, private placement, bank loan) and investment of proceeds</li> <li>• Use of comparative bond pricing services or market indices as a benchmark in negotiated transactions, as well as evaluate the final bond pricing results,</li> <li>• Criteria for issuance of advance refunding, current refunding, and taxable bonds</li> <li>• Use of credit ratings, minimum bond ratings, determination of the</li> </ul>	<p>Debt will be issued by the Regional Municipality of Durham. The selection of professionals, criteria for sale method, use of bond ratings would all be outside the scope of which the Municipality of Clarington has authority.</p>

GFOA Debt Management Policy Recommendation	Municipality of Clarington Proposed Debt Management Policy
<p>number of ratings, and selection of rating services.</p>	
<p><b>Debt Management Processes</b></p> <p>The policy should provide guidance for ongoing administrative activities, including:</p> <ul style="list-style-type: none"> <li>• Investment of bond proceeds</li> <li>• Primary market disclosure practices and procedures, including annual certifications as required</li> <li>• Continuing disclosure procedures</li> <li>• Arbitrage rebate monitoring and filing</li> <li>• Monitoring of tax-exempt bond-financed facilities for private use</li> <li>• Federal and state (province) law compliance practices, and</li> <li>• Ongoing market and investor relations efforts</li> </ul>	<p>The policy requires reporting to Council on debt issuance, as well as forecasting of debt needs for capital, asset management and budgeting purposes.</p> <p>The policy requires the Municipality to follow Province of Ontario legislation for the issuance of debt and adherence to the annual repayment limit.</p>
<p><b>Use of Derivatives</b></p> <p>The Debt Management Policy should clearly state whether or not the entity can or should use derivatives. A separate and comprehensive derivatives policy should be developed if the policy allows for derivatives.</p>	<p>The structure of debt issuance is the responsibility of the Region of Durham. There is no intent to suggest derivatives be used for debt issued on behalf of the Municipality of Clarington.</p>

### **3. Concurrence**

Not Applicable.

### **4. Conclusion**

It is respectfully recommended that Council approves the attached Debt Management Policy.

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Attachments:

Attachment 1 – Debt Management Policy