

Corporate Policy

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POLICY TYPE:	Financial
SUBSECTION:	
POLICY TITLE:	Debt Management Policy
POLICY #:	TBD
POLICY APPROVED BY:	Council
EFFECTIVE DATE:	September 20, 2021
REVISED:	
APPLICABLE TO:	All Departments

1. Purpose

- 1.1 The Municipality of Clarington is committed to demonstrating good governance and ensuring prudent management of the Corporation's debt.
- 1.2 The Debt Management Policy establishes principles, objectives, authorized financial instruments, reporting requirements and responsibilities for the prudent debt financing of the Corporation's operating and infrastructure needs.

2. Scope

- 2.1 The Debt Management Policy pertains to all municipal employees who are responsible for the control, administration and management of the Municipality's financial and capital requirements.

Definitions

- 2.2 **Approved Annual Budget** – The annual operating budget adopted by Council which is the basis for any tax-rate change in a single fiscal year.
- 2.3 **Approved Capital Budget** – The budget estimate for capital project(s) and or capital program(s) that has been adopted by Council and is the level at which Council approves funding.
- 2.4 **Annual Debt Financing Charge** - The estimated amount of operating budget funds, in a respective year's Approved Annual Budget, required to meet the year's share of mandatory payments in respect of outstanding debt, ie. Principal and interest payments.

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- 2.5 **Annual Debt Repayment Limit** – The internal limit set by this policy for financial sustainability purposes and based on recommended best practices. It shall not exceed the Annual Repayment Limit.
- 2.6 **Annual Repayment Limit** – The calculation provided annually to a municipality by the Ministry of Municipal Affairs and Housing, or successor, that determines the maximum amount of additional debt servicing costs that a municipality can undertake or guarantee without seeking approval of the Province of Ontario.
- 2.7 **Asset Management Plan** - A plan developed for the management of assets that combines multi-disciplinary management techniques over the life cycle of the asset in the most cost-effective manner to provide a specific level of service.
- 2.8 **Bank Loan** - A loan between the Municipality and a Canadian Schedule I, II or III bank, a loan corporation registered under the Loan and Trust Corporations Act, or a credit union to which the Credit Unions and Caisse Populaires Act, 1994 applies
- 2.9 **Capital Financing** - A generic term for the financing of capital assets using reserve and reserve funds
- 2.10 **Debentures**- A debt instrument issued by a municipal corporation and secured by municipal general fund revenues. They are formal written obligations to repay specific sums on certain dates. In our two-tiered Regional government, the regional municipality issues debentures on behalf of the lower tier.
- 2.11 **Debt** - An obligation for the repayment of money. For Ontario municipalities, long-term debt normally consists of debentures; short-term debt normally consists of notes or loans from financial institutions. Inter-fund borrowing, and debentures issued to Infrastructure Ontario are also considered to be debt.
- 2.12 **FIR** – is the abbreviation for the Financial Information Return provided annually by municipalities to the Ministry of Municipal Affairs and Housing.
- 2.13 **Inter-fund Borrowing** – under which financial resources are internally transferred from one fund to another with the intent to repay the borrowed funds plus applicable interest. If inter-fund borrowing is long-term in nature it shall be reported to the Region of Durham.

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- 2.14 **Long-term debt-** A term longer than one fiscal year. If the Municipality incurs debt that will not be repaid within a fiscal year, this borrowing must go through the Region of Durham.
- 2.15 **Municipal Act-** The *Municipal Act, 2001* is the main statute governing the creation, administration and government of municipalities in the Canadian province of Ontario.
- 2.16 **Net Revenue** – is the base number that is used to calculate the Provincial and Policy debt limit. It is considered own-source revenue and does not include grant revenue from senior levels of government.
- 2.17 **Reserves** – an allocation of accumulated surpluses that make no reference to any specific asset and does not require the physical segregation of money. Reserves are part of the general fund and therefore do not earn interest like a reserve fund.
- 2.18 **Reserve Fund** – are segregated monies restricted to meet a specific purpose and are established either through by-law of the Municipality, legislation or agreement. Reserve funds are generally disbursed to fund long-term financial strategies and capital projects. Reserve funds receive an annual interest allocation based on the average annual balance. There are two types of reserve funds, obligatory and discretionary;
- **Obligatory Reserve Funds** are reserve funds established by legislation or agreement for a unique purpose on behalf of the contributor. Examples are Development Charges and Federal Gas Tax funds.
 - **Discretionary Reserve Funds** are reserve funds established for a specific purpose by Council for future expenditures. Examples are Rate Stabilization and Strategic Capital.
- 2.19 **Short-term debt-** A term equal to or less than one fiscal year. This type of borrowing does not require upper tier approval.
- 2.20 **Sinking Fund** – A segregated pool of funds managed by the Region of Durham for which an estimated amount in each year, with interest compounded annually, will be sufficient to pay the principal of the related Sinking Fund Debentures at maturity.

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2.21 **Retirement Fund** – A segregated pool of funds managed by the Region of Durham for a class of Debentures other than a sinking fund or term debenture. In each year the fund must contain an amount equal to or greater than the amount required for the repayment of the principal of specific Debentures in that year if the principal had been payable in equal annual instalments and the Debentures had been issued for the maximum period authorized by the Municipality for the repayment of the Debt for which the Debentures were issued.

3. Policy

3.1 Philosophy for Debt Issuance

- 3.1.1 Ensure debt issuance decisions align with the Development Charges Study, Long-term Financial Plans and Asset Management Plans, while promoting long-term financial flexibility, internal controls and sustainability.
- 3.1.2 Prior to the issuance of any new debentures or the incurrence of additional debt, 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.
- 3.1.3 Council may, where it is deemed in the best interest of taxpayers, approve the issuance of debt for its own purposes.
- 3.1.4 Debenture practices will be responsive and fair to the needs of both current and future taxpayers and will be reflective of the underlying life cycle and nature of the corresponding expenditure(s).

3.2 Primary Considerations of the Debt Program

- 3.2.1 The primary considerations for the capital financing and debt program, in order of importance, shall be:
 - Adhere to statutory requirements;
 - Ensure long-term financial flexibility;
 - Limit financial risk exposure; and

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- Minimize the cost of long-term financing

3.3 Adhere to Statutory Requirements

- 3.3.1 Capital financing utilizing debt may only be undertaken if and when it is in compliance with the relevant sections of the Municipal Act.
- 3.3.2 The term of temporary or short-term borrowing for operating purposes will not exceed the current fiscal year.
- 3.3.3 The term of the capital financing will not exceed the lesser of 40 years, or the useful life of the underlying asset being financed.
- 3.3.4 Long-term debt (borrowing) will only be issued for capital projects owned by the Municipality of Clarington.
- 3.3.5 Under section 401 of the Act, the Region of Durham issues long-term debentures on behalf of the Municipality of Clarington, including the administration of Sinking Funds and Retirement Funds.

3.4 Ensure Long-term Financial Sustainability and Flexibility

- 3.4.1 The Municipality of Clarington recognizes that the prudent issuance of debt can be an efficient use of available resources and assist with achieving the goals of the Corporation. Council may, where it is deemed to be in the best interest of its taxpayers and in line with the appropriate financial plan, approve the issuance of debt. Capital financing and debenture practices will be responsive and fair to the ratepayers while effective of the Asset Management Plan, Development Charges Study, and Long-term Financial Plan.
- 3.4.2 To the extent possible, regular and/or ongoing capital expenditures and the current portion of future rehabilitation and replacement costs will be recovered on a “pay as you go” basis through rates, tax levy, user fees or reserve funds. Adequate reserve and reserve funds must be developed and maintained for all capital assets owned by the Corporation to ensure long-term financial flexibility.

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3.5 Establishment of Debt limits

3.5.1 The *Municipal Act* restricts the Municipality's ability to take on debt, such that the annual principal and interest payments cannot exceed an Annual Repayment Limit of 25 per cent of own source revenues.

3.5.2 Clarington will impose our own Annual Debt Repayment Limit that will not exceed 15 per cent of our own source revenues. Own source revenues exclude government grants, development charges, gains or losses on disposal of assets, and revenues from other municipalities.

3.5.3 The Municipality shall limit the amount of debt issued on an annual basis by applying debt financing to projects in the capital budget in a manner consistent with the following:

- Debt financing shall be avoided, where possible, as a source of funding for lifecycle renewal projects.
- New infrastructure requirements.
- Projects where the cost of deferring expenditures exceeds debt servicing costs.
- Debt financing may be utilized as a source of funding for growth projects.
- Debt financing may be utilized as a source of funding for service improvement projects.

3.5.4 The Treasurer shall have the authority to change the above application of debt financing as a source of funding for projects in the capital budget.

3.6 Availability of Debt Capacity for Future Priority Projects

3.6.1 The Municipality has many spending priorities for the limited amount of revenues collected each year. The capacity to issue debt is directly related to its ability to make the payments required on the debt for both annual interest and principal payments. This in turn is related to the ability of the citizens to be able to sustain increases in taxes or user fees.

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3.6.2 The Corporation could face risk, in any fiscal year, of having insufficient debt capacity to fully execute its capital plan, based on its annual debt repayment policy limit.

3.6.3 To manage this risk, the capital plan will show the amount of debt financing that will be required for each project and each year of the plan. Each project will be prioritized by management during the budgetary process on the basis of its impact on the long-term financial plans of the Municipality.

3.7 Limit Risk Exposure

3.7.1 Debt financing will be managed in a manner to limit, where practicable, variations in costs. A preference to amortizing debt, structures where the payments are equal throughout the term, provides for stable cost of debt throughout the term.

3.7.2 To manage interest rate risk, it will be normal practice to require debentures be issued with fixed rates over the term of the debenture. This provides known costs of borrowing and is not subject to fluctuations in interest rates.

3.7.3 To manage foreign exchange rate risk, all debt shall be denominated in Canadian dollars.

3.8 Minimize Long-term Cost of Financing

3.8.1 Timing, type and term of debt financing for the approved capital budget will be determined in order to minimize the overall cost of long-term financing. Typically, shorter term interest rates (five-year) are lower than longer term interest rates (20 years).

3.8.2 To minimize interest costs over time the Municipality shall have a term preference of 10 years for debentures or other types of long-term financing for capital works. The term of the long-term financing shall not extend the shorter of:

- the lifetime of the capital work for which the debt was incurred and
- 40 years in accordance with the *Municipal Act*.

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3.8.3 Due to the administrative costs of issuing debt, it is not cost-effective to borrow for small value projects. Debentures shall only be issued for individual projects, or groups of similar projects, where the debenture request is greater than \$1 million.

3.8.4 The length of the term will be at the discretion of the Treasurer but in accordance with the *Municipal Act*

4. Types of Borrowing

4.1 Short-term Borrowing

4.1.1 Short-term borrowing may be used to

- Cover a gap in financing for capital projects being financed with long-term debt.
- To cover the timing difference between the payment of operating expenditures and the receipt of tax revenues for the year.

4.1.2 Options for short-term borrowing are as follows:

- An inter-fund loan from reserve funds or reserves
- Short-term promissory note
- Line of Credit from a bank or financial institution

4.1.3 In accordance with the *Municipal Act*, the Municipality is authorized to borrow in the short term, from a bank or other financial institution.

4.2 Long-term Borrowing

4.2.1 Financing of assets for a period of greater than one year, may take the form of any of the following sources:

- Debentures coordinated with the Region of Durham
- Interfund Notes (IFN) – with notification to the Region of Durham

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4.3 Inter-fund Borrowing

- 4.3.1 Under some circumstances, one fund will provide financial resources to another fund to support its operations.
- 4.3.2 Inter-fund borrowing is permitted for cash flow purposes where there is a reasonable expectation that the funds can be repaid with applicable interest.
- 4.3.3 Long-term borrowing is permitted for capital projects provided that the lending fund has the funds available, that the borrowing will not adversely affect the lending funds' long-term financial condition, and that a specific source of repayment has been identified in the borrowing fund.
- 4.3.4 Applicable interest rates on inter-fund borrowing would match the prevailing rates which would be incurred if the borrowing was external. The Treasurer shall have the authority to set the exact rate and a repayment schedule shall be set.
- 4.3.5 The Treasurer, or delegate, is authorized to approve short term inter-fund borrowing for cash flow or other purposes.

5. Responsibilities

- 5.1 Officers and staff of the Municipality complying with this Policy shall have the necessary authority to carry out the responsibilities and duties identified therein.
- 5.2 The Director of Financial Services/Treasurer will have the overall responsibility for the capital financing program of the Corporation.
- 5.3 The Designated position(s) under the Director of Financial Services/Treasurer will have the responsibility of directing and implementing the activities of the capital financing program and the establishment of procedures consistent with this policy.
- 5.4 No person shall be permitted to engage in a capital financing activity except as provided for under the terms of this policy. The Director of Financial Services/Treasurer shall establish a system of controls to regulate the activities of subordinate officials and exercise control over the staff.

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5.5 The Director of Financial Services/Treasurer shall also have the following specific responsibilities:

- Reviews and recommends the type and term of financing for capital and operating requirements
- Calculates limits for financial obligations in accordance with the Municipal Act
- Coordinates the preparation of debt issue by-laws for Council
- May execute and sign documents on behalf of the Corporation and perform all other related acts with respect to the issuance of debt securities, including the payment of principal, interest and other fees

5.5.2 The Municipal Clerk may certify and sign documents on behalf of the Municipality with respect to the issues of debt securities

5.6 The Municipality's staff will be expected to have sufficient knowledge to prudently evaluate standard financing transactions; however, should in their opinion the appropriate level of knowledge not exist for instances such as capital financing transactions that are unusually complicated or non-standard, or as otherwise directed, outside financial and/or legal advice will be obtained.

6. Reporting

6.1 Annually, the Director of Financial Services/Treasurer shall submit to Council a report, or reports, that:

- Requests authority for temporary borrowing up to a stipulated amount to meet day-to-day expenditures, pending receipt of tax levies, user fees and revenues anticipated during the year;
- Requests authority, if required, to finance certain capital items detailing for each type of item, the amount and the maximum term of financing;
- As part of the annual budget, a Long-term Debt Forecast and Financial Obligation Management Plan that includes

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- projections for each year over a multi-year period of estimated long-term debt and financial obligation payments compared to the annual debt repayment policy limit; and
 - A statement indicating that the debt management plan is in compliance with this policy.

6.1.1 The Director of Financial Services/Treasurer will report annually to Council on the key indicators that will influence the use of debt and long-term financial sustainability include, but are not limited to:

- Debt interest as a % of Net Revenue
- Debt charges as a % of Net Revenue
- Debt outstanding per Capita
- Debt Outstanding per Net Revenue
- Debt to Reserve Ratio
- Debt Outstanding as a % of Unweighted Assessment

6.2 In addition to the annual requirements above, the Director of Financial Services/Treasurer shall provide to Council any information requested or that the Director deems appropriate.

7. Policy Review

7.1 This policy shall be reviewed no less than once per term of Council or if deemed necessary.