

CITYOF CHESTERMERE

POLICY HANDBOOK

EFFECTIVE DATE: October 3, 2016	POLICY: 448
APPROVED BY: Council	SUBJECT: Capital Financing and Debt Management
REVISED DATE: September 17, 2018	PAGE NO.: 1 of 8
EXPIRY DATE: N/A	POLICY TYPE: Finance

PURPOSE AND INTENT

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. The intention of the Capital Financing and Debt Management practices of the City is to obtain the best value possible with regards to the cost of financing of the City's projects and asset acquisitions, using internal or external financing resources.

DEFINITIONS

Average Investment Earnings – means the amount of investment earnings received on the investment, if known for the current year, or received from the prior year investments and used as part of the year-end procedures and credited to the Restricted Surplus Accounts, as documented in the Restricted Surplus Account Policy #447.

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, swaps and other derivatives.

Construction Financing - a form of debt financing in which the issuer does not pay any principal or interest for a period of up to 5 years during the construction or rehabilitation project from which a revenue stream is expected to be generated.

Debenture - a formal written obligation to repay specific sums on certain dates. In the case of the Municipality they are typically unsecured.

Debt - any obligation for the payment of money. For Alberta municipalities, debt would typically consist of debentures as well as either notes or cash loans from financial institutions. Could also include loans from restricted surplus funds.

Debt Service Cost – means debt repayments, including interest and principal

Emergency - an event that requires prompt co-ordination of action or special regulation of persons or property to protect the safety, health or welfare of people or to limit damage to property

Infrastructure – large-scale public systems, services, and facilities of the City that are necessary for economic activity in the community.

Internal Debt – using funds from the Investment Account to fund capital projects for a short-term period or operations for current year only.

Lease Financing Agreements - a lease allowing for the provision of Municipal Capital Facilities if the lease may or will require payment by the Corporation beyond the current term of Council.

Long-term Bank Loan - long term debt provided by a bank, or syndicate of banks.

Long-term Debt - any debt for which the repayment of any portion of the principal is due beyond one year.

Mortgage - the charging of real property by a debtor to a creditor as security for a debt (especially one incurred by the purchase of the property), on the condition that it shall be returned on payment of the debt within a certain period.

Municipality - the City of Chestermere.

Project Financing - financing in which principal and interest payments are structured so as to more closely match the revenues or cost savings of a specific project. Also includes financing for which the lender, in the case of default, would have no or limited recourse to the issuer beyond the assets purchased with the proceeds of the financing.

Restricted Surplus Account - account created when funds are set aside (designated) for a future purpose. Funds within a Restricted Surplus Account are restricted and will be applied as outlined in the approved Restricted Surplus Account Policy.

Rolling Stock - equipment that moves on wheels used for transportation and/or transit purposes. Examples include, trucks, buses, and tractor trailers.

Short-term Debt - any debt for which repayment of the entire principal is due within one year.

Statutory Annual Debt Limit – means the total debt and financial obligation limit for municipalities as described under Alberta regulation 255/2000. The regulation provides a formula which limits total debt for the municipality to an amount equal to 150% of operating revenue.

Statutory Annual Debt Repayment Limit – means the annual debt and financial obligation limit for municipalities as described under Alberta regulation 255/2000. The regulation provides a formula which limits annual debt service costs to an amount equal to 25% of operating revenue.

Tax-Supported Debt - means debt issued for capital expenditures related to tax-supported operations.

POLICY

1. Approach and Procedure

- a. 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 entities.
- b. 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.
- c. Financing may only be undertaken if and when it is in compliance with the relevant sections of the *Municipal Government Act*.
- d. The 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 probable lifetime of the capital property, and will be equal to or less than the specific asset useful life stated in the financial statement;
 - iii. Long-term debt will not be issued for operating projects;
 - iv. Debt financing will not be incurred if the borrowing will cause the municipality to exceed its debt limit as determined in accordance with the regulations under section 271 of the *Municipal Government Act*;
 - v. The total annual financing charges cannot exceed the Annual Debt Service Limit;
 - vi. 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 compared to other methods of financing;

- vii. Prior to passing a debenture by-law Council will have considered all financial and other risks related to the proposed project;
- viii. 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 approved Procurement Policy.

2. Purposes for which long-term debt may be issued

The City may borrow by debenture, mortgage or other acceptable debt instrument to finance the construction, purchase, replacement or major restoration of infrastructure with an individual project value exceeding \$500,000. The projects will appear in the approved Capital Plan or as approved by Council. Long-term debt will not be used to finance operating expenditures.

3. Debt Limits

- a. The City cannot exceed the debt limits as determined in accordance with the regulations under section 271 of the *Municipal Government Act*.
- b. Long-term debt will only be incurred as a last resort when other alternative funding sources have been exhausted.
- c. The City further restricts the debt level of the municipality to 75% of the maximum level established by the Provincial regulation, unless the capital expenditure is required for one or more of the following purposes:
 - i. Environmental or safety related regulatory standard upgrades/new development;
 - ii. Unexpected emergency or disaster, requiring a significant capital expenditure to replace damaged infrastructure.

4. Other limitations on incurring long-term debt:

- a. Long-term debt will not be incurred for the purchase or lease of rolling stock, except for emergency vehicles.

5. Short-term debt:

- a. The City has an operating line of credit of \$1.2 million in place which may be used to manage cashflow;
- b. The use of the line of credit or other form of short-term debt could be incurred for projects with a cost under \$500,000 or for capital projects where long-term debt has not yet been determined to be a primary source of financing (ie: where grant funding

or developer contributions are anticipated but timing is not aligned with project financing requirements).

6. Approved source of long-term debt

Acceptable sources of long-term debt include:

- Restricted Surplus Funds (internal borrowing)
- Loan from a financial institution
- Debenture from Alberta Capital Finance Authority

When sufficient funds are available in the City's eligible restricted surplus funds and it is determined that the use of these funds will not adversely affect the intended purpose of the restricted surplus fund, the City's restricted surplus funds may be used as a source of financing for short- to long-term purposes.

The restricted surplus funds that are used for projects identified in the Offsite Levy Plan will be repaid with interest, at the **greater of** the ACFA rate **or** the Average Investment Earnings at the time the project is approved.

Each internal such loan is to be authorized by a specific by-law passed by Council which sets out the purpose for the loan, the loan amount, interest rate, term of the loan, repayment terms, loan amortization period and the specific restricted surplus fund from which the loan is made.

Borrowing in this manner offers several advantages over traditional debenture financing which may include the following:

- Increased flexibility in setting loan terms,
- Equal or lower interest cost, and
- Avoidance of fees related to financing arrangements.

If sufficient funds are not available in restricted surplus to provide long-term financing or it is deemed more appropriate to seek another source, the ACFA or another acceptable lender will be used based on the most attractive lending terms for the project.

7. Early repayment of debt

Borrowings will only be repaid before the scheduled repayment date if it appears to be financially beneficial to do so. In considering whether it is financially beneficial, any additional external costs involved will be considered.

8. Integration of the Five Year Capital Plan Budget and debt issues

When reviewing the Five Year Capital Plan, Administration will present for the consideration of Council, the need for any long-term financing.

It is the intention of this policy to have the Five Year Capital Plan use funding sources other than additional long-term debt to finance major capital expenditures. Incurring debt will

only be used as the last option. Should any long-term borrowing be required in the Five Year Capital Plan, Council will be specifically advised.

9. Use of debt borrowing proceeds

Investment interest earned on funds borrowed, until required to offset expenditures, will normally be credited to the project which is being financed. Exceptions may be made for large borrowings or where regulations require specific procedures to be followed.

10. Strategy for financing capital requirements using internal borrowing in lieu of incurring debt

The City has established Restricted Surplus Accounts for lifecycle, replacement and maintenance of existing assets and acquisition of new assets and it is Council's priority to use existing available funds to finance major capital expenditures in lieu of long-term debt.

11. Reporting

- a. The annual municipal financial statements will provide the statutory reporting on the municipality's short and long term debt, debt limit and other financing transactions, as required.
- b. Quarterly, or more often, if requested, the Restricted Surplus Account Summary will be provided to Council which will outline the status of any internal financing that has occurred with Restricted Surplus Funds providing the funding source for financing of municipal projects.
- c. Other performance measures of debt levels for the City could include: debt/capita; debt to taxable property value; debt service payments as a percentage of general fund revenues or expenditures; debt to Restricted Surplus Fund ratio.

Direct Debt to Taxable Property Value

- i. This ratio compares direct debt to the total taxable property value. This measure provides a ratio that can be compared to other municipalities.

Debt Service Cost to Net Revenue Fund Revenue

- ii. This ratio is a measure of the principal and interest payable annually as a proportion of revenue fund revenues. It should not exceed a target of 10%.

Direct Debt to Restricted Surplus Fund Ratio

- iii. This ratio compares direct debt to the total of all restricted surplus funds. A generally accepted target ratio for municipalities is considered to be 1:1.
- d. As part of the budgeting process, the Controller will provide a Debt Financing overview which will outline the details of the debt currently held by the

municipality along with any outstanding debentures, mortgages or other loans that will mature during the budgeting timeframe.

- e. Debt payments from retired loans will be deposited into the General Corporate Stabilization Restricted Surplus Account or the Infrastructure Lifecycle and Maintenance Restricted Surplus Account as described in the Restricted Surplus Account Policy.

12. Roles and Responsibilities

The personnel of the municipality complying with this Policy shall have the necessary authority to carry out the responsibilities and duties identified within the Policy.

a. Departments

- i. The City's Capital Plan along with Departmental Business plans will identify the need for debt financing. Directors will advise the Controller of any plans to incur debt financing through the budgeting process and then, well in advance (at least 60 days) of the project commencement for which debt will need to be incurred, the Director will advise the Controller of the timing of financing requirements.

b. Financial Services

- i. The Controller has overall responsibility for the advice and reporting relating to the financing program of the Municipality and for overseeing the implementation of this Policy.
- ii. The Controller shall establish a system of controls to regulate the activities related to debt financing for the municipality.
- iii. The Controller shall calculate the financial debt and obligation limit for the municipality as prescribed by the *Municipal Government Act Regulations*.
- iv. The Controller shall provide the reporting as outlined in this Policy.
- v. The Controller shall coordinate the preparation of Borrowing Bylaws for presentation to Council for any municipal borrowing that is requested.

c. External Advisors

- i. Municipal staff will be expected to have sufficient knowledge to prudently navigate standard financing 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.

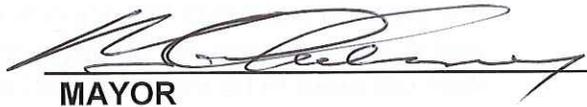
13. Policy Review

This Policy will be reviewed prior to each 4-year budget cycle.

Related Documents

Restricted Surplus Policy #447
Proposed Procurement Policy #652

Adopted by Council: *Sep 17, 2018*
Resolution Number: *393-18*



MAYOR



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