CITY OF VAUGHAN

CORPORATE POLICY

POLICY TITLE: **CORPORATE DEBT**

POLICY NO.: **12.C.09**

Section:	Finance & Budgets		
Effective Date:	January 1, 2021	**Date of Last Review:**	Click or tap to enter a date.
Approval Authority: Council		**Policy Owner:** DCM, Corporate Services & CFO	

POLICY STATEMENT

The issuance of debt and debentures can play a very important role in the City's finances. They can provide liquidity to fund renewal and replacement of assets and infrastructure and fund other capital projects, spreading payments over the life of the asset rather than entirely upfront.

The City of Vaughan is committed to ensuring municipal governance by establishing a Corporate Debt Policy to provide guidelines and standardize practices, which will assist in the administration of debt and debentures issued in a responsible and consistent manner and provide clarity regarding management and reporting requirements.

The City of Vaughan recognizes that the prudent issuance of debt and/or debentures must be made in the context of the optimum utilization of all available financial resources within statutory limitations and recognizes the basic need to protect and preserve capital while maintaining solvency and liquidity to meet ongoing financial requirements.

PURPOSE

The purpose of the Corporate Debt policy is to establish financial guidelines and appropriate controls for the issuance and management of debt for the City of Vaughan. This policy establishes objectives, standards of care, authorized financing instruments, reporting requirements and responsibilities for the prudent financing of the City's infrastructure needs.

SCOPE

This policy applies to all future debt financing that may be issued by the City of Vaughan.

LEGISLATIVE REQUIREMENTS

The City is permitted to enter into corporate debt under the provisions and requirements of the Municipal Act, 2001 (the "Act).

The City will only undertake issuance of Debt in compliance with the provisions of the Municipal Act 2001 (the Act) and its regulations governing the issuance of debt, specifically:

s.1.j. Part XIII – Debt and Investment, as well as Ontario Regulation 403/02 (Debt and Financial Obligation Limits);
s.2.j. Ontario Regulation 438/97 (Eligible Investments and Related Financial Agreements);
s.3.j. Ontario Regulation 247/01 (Variable Interest Rate Debentures and Foreign Currency); and
s.4.j. Ontario Regulation 276/02 (Bank Loans), as amended.

Debentures cannot be issued to finance current operations. The use of money received will be applied only for the purposes which the debentures were issued or for repayment of outstanding temporary borrowing. The City is permitted under Section 407 of the Act to draw on temporary borrowing facilities, in a tax year, pending receipt of tax revenues and passes a Temporary Borrowing By-law annually to provide the necessary authority.

Requirements include and not limited to the following:

1. The term of temporary or short-term debt for operating purposes will not exceed the current fiscal year;

2. The term of the capital financing will not exceed the lesser of 40 years or the useful life of the underlying asset;

3. Long-term debt will only be issued for capital projects;

4. The total annual financing charges cannot exceed the Growth-related Debt Servicing Ratio and Debt Servicing Ratio Limit, as applicable, for the municipality responsible for incurring the debt unless otherwise approved by the Ontario Municipal Board;

5. Council has adopted or affirmed a Long-Term Debt and Financial Obligations

Management Plan for each fiscal year that a Growth-related Cost Supplement is required;

6. 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;

7. Prior to passing a debenture by-law which provides that installments of principal or interest, or both, are not payable during the period of construction of an undertaking, Council will have considered all financial and other risks related to the proposed construction financing;

8. A credit rating of AA - (or equivalent) will be maintained for the year and the prior year that a Growth-related Cost Supplement is required; and

9. Long-term debt will be the joint and several obligations of the Corporation and its area municipalities.

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 York ("*Region*") on the City's behalf. The City is responsible for budgeting the annual debt repayment obligations, transferring the debt payment to the Region, and managing the proceeds of the debentures.

The City may also issue debt directly through Infrastructure Ontario, a crown agency of the Province of Ontario, with approval of Council and the Regional Municipality of York.

DEFINITIONS

1. **Act:** The Municipal Act, 2001, S.O. 2001, c25 as amended. The *Municipal Act* is the statue governing the powers, duties, internal organization, and structure of Ontario municipalities.

2. **Annual Debt Financing Charges:** Estimated amount of operating budget funds, in a respective year's Approved Annual Budget, required to meet that year's share of mandatory payments in respect of outstanding Debentures, i.e. principal and interest payments, or payments of interest and contributions into Sinking or Retirement Funds.

3. **Annual Debt Repayment Limit:** Maximum amount of annual debt servicing costs that the City can undertake or guarantee without seeking the approval of the Ontario Municipal Board. 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. Refer to Regulation 403/02. The Regulation provides a formula which limits the annual debt services costs to an amount equal to 25% of operating revenue (owned sourced revenue).

The City of Vaughan's internal Annual Debt Repayment Limit is established at 10% of operating revenues which will be the limit set out in this policy.

4. **Approved Annual Budget:** Annual Current (Operating) budget adopted by Council, and which is the basis for any tax-rate change in a single fiscal year.

5. **Approved Capital Budget:** 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 and fund controls.

6. **Bank Loan**: A loan between the City and a bank listed in Schedule I, II or III of the *Bank Act (Canada)*, a loan corporation registered under the *Loan and Trust Corporations Act* or a credit union to which the *Credit Unions and Liaison Populaires Act, 1994* applies.

7. **Bankers' Acceptance**: A Short-Term credit obligation created by a non-financial firm, such as a corporation, which is endorsed by a bank, effectively making the obligation that of the bank.

8. **Capital Reserve Fund**: Monies set aside for the repair, major maintenance, rehabilitation and replacement of capital infrastructure and for other large approved tax funded capital expenditures, including principally but not limited to Asset Repair and Replacement.

9. **Debenture**: A formal written obligation to repay specific sums on certain dates. Debentures issued by a municipality are typically unsecured and are backed by the good faith and credit of the municipality. Municipalities are authorized to issue Debentures for long-term financing of capital projects. Authorized types of debentures include sinking funds, installment (serial); term; amortizing; retirement funds; construction financing and variable interest rate.

10. **Debt:** Any obligation for the repayment of money. For Ontario municipalities, Long-Term Debt would normally consist of debentures, capital or financing leases, as well as notes or cash loans from financial institutions, but could also include loans from Reserves and Reserve Funds, Sinking Funds or an Endowment Fund. Debentures issued to Infrastructure Ontario are also considered a Debt.

11. **Debt and Financial Obligation Limit**: The limit or amount determined annually for a municipality by the Ministry of Municipal Affairs and Housing (MMAH) that

constitutes the maximum amount of new annual debt servicing costs that a municipality can undertake, or guarantee, without seeking prior approval of the Ontario Municipal Board (OMB), as prescribed by Ontario Regulation 403/02 (Debt and Financial Obligation Limits). MMAH calculates and report annually to the Treasurer the Annual (Debt) Repayment Limit (ARL), as required by the legislation and related regulations. The Treasurer shall recalculate an updated limit using the most recent ARL and provide this to Council before Council authorizes any specific work or class of work or any increase in expenditure for a previously authorized specific work or class of work that requires issuance of long-term debt.

12. **Development Charges**: Charges imposed under the City of Vaughan's Development Charges By-Laws (#396-2002), as prescribed by the Ontario Development Charges Act, 1997, to fund new infrastructure and capital facilities required due to growth of the City.

13. **Flexibility**: The ability of the City to issue new debt in response to emerging financial issues.

14. **Infrastructure Ontario**: Entity established by the Province of Ontario to provide eligible public organizations such as Ontario municipalities, universities and hospitals access to alternative financing service for longer-term fixed rate loans for the building and renewal of public infrastructure.

15. **Lease Financing Agreement**: 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.

16. **Long Term Bank Loan**: Long-Term Debt provided by a bank or syndicate (group) of banks.

17. **Long Term Debt**: Any Debt for which the repayment of any portion of the principal is due beyond one year.

18. **Municipal Capital Facilities**: Includes land, as defined in the Assessment Act, works, equipment, machinery and related systems and infrastructures.

19. **Net Revenues**: Total City consolidated revenues less grants from other levels of government less sales of land development charges earned. These revenues do not include donations of tangible capital assets.

20. **Operating (Current) Budget Forecast**: Projection of expenditures, revenues and staffing levels beyond the Approved Annual Budget year in which the forecast is made.

21. **Own-Source Revenue**: Revenue for a fiscal year, excluding:

    21.1. Grants from the Government of Ontario or Canada or from other government type bodies such as Conservation Authorities, Commissions, Crown Corporations and Agencies, or from another municipality.
    21.2. Proceeds from the sale of real property.
    21.3. Contributions or net transfers from a reserve or Reserve Fund
    21.4. Government of Ontario revenues received for the purpose of repaying the principal and interest of Long-Term Debt, toward meeting financial obligations of the municipality.

22. **Reserve Fund**: A fund that is segregated and restricted to meet a specific purpose. Monies set aside for a Reserve Fund must be deposited into a separate bank account and the interest earned on those investments must be added to the Reserve Fund.

23. **Short-Term Debt**: Any debt obligation for which the repayment of the entire principal is due within one year.

24. **Sinking Fund**: A segregated pool of funds managed by York Region for which an estimated amount contributed in each year, with interest compounded annually, will be sufficient to pay the principal of the related Sinking Fund Debentures at maturity.

25. **Retirement Fund**: A segregated pool of funds managed by York Region 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 installments 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.

26. **Tax Supported Debt**: Debt that is to be recovered from non-water and sewer revenues sources and includes growth related debt. Repayment of this growth-related debt (principal and interest) shall be recoverable through the City's development charges.

27. **User Rate Supported Debt**: Debt that is to be recovered from water and sewer user fee revenues and includes growth-related debt. Growth-related debt (principal and interest) shall be recoverable through the City's development charges.

28. **Variable Interest Rate Debentures**: Debentures that provide for one or more variations in the rate of interest payable on the principal during the term of the Debentures.

POLICY

While debt is not a funding source, it is recognized that debt can be an efficient and effective financing tool when utilized appropriately and equally important tool while establishing a long-range financial sustainability plan. Utilizing debt must be done with consideration of affordability while maintaining fiscal flexibility to respond to future financial challenges and opportunities. It is important to identify how the resulting debt payments will be funded (property taxes, development charges, etc.).

1. Qualifying Criteria for Debt Utilization

New debt issuances shall be limited to:

1.1. New infrastructure requirements;

1.2. Programs/facilities which are self-supporting, or financed by a dedicated revenue stream or expenditures savings;

1.3. Projects where the cost of deferring expenditures exceed debt servicing costs;

1.4. 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);

1.5. Apart from land, the estimated useful life of the asset is greater than five years; and,

1.6. The project has been approved by Council as part of the annual capital budget (or other finance document/report) and had clearly been identified as being funded by debt.

2. Disqualifying Criteria for Debt Utilization

2.1. The City will only issue debt to finance capital expenditures and will not use debt to fund operational needs;

2.2. The City should not use debt to fund regular/ongoing capital maintenance or rehabilitation expenditures; and,

2.3. The City will not fund the purchase of vehicles and small equipment, computer hardware and software through long-term debt even though their life expectancy, in some instances, may be greater than five years. This excludes heavy equipment such as graders and emergency equipment such as fire trucks.

2.4. As of the effective date of this policy (January 1, 2021), the City shall not issue debt on behalf of any external agency or organization or guarantee debt issued directly by an external agency or organization, unless directed by Council.

3. Eligible Capital Projects

The following types of capital works items are eligible for long-term debt financing:

3.1. New growth-related development charge funded infrastructure. Repayment of this type will be recovered through future development charge revenues received;

3.2. New Municipal Capital Facilities and Infrastructure not funded through Development Charges:

3.2.1. Projects of a general function of government will be paid for with general tax revenues; and,
3.2.2. Water and sewer related projects to be financed from user rates.

3.3. Major rehabilitation or reconstruction of existing assets as a short-term strategy to address significant backlogs or emergency situations (e.g. roads or bridge repair);

3.4. Projects that provide future cost savings or cost avoidance;

Maximum terms for each asset or type of capital project is provided in Appendix A.

4. Ensure Long-Term Financial Flexibility and Sustainability

4.1. The capital financing program will be managed in a manner consistent with other long-term planning, financial and management objectives. Prior to the issuance of any new capital financing, 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.

4.2. To the extent practicable, 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 and/or reserve fund monies. Adequate reserves must be developed and maintained for all capital assets owned by the Corporation to ensure long-term financial flexibility. However, where long-term financing is required, due consideration will be given to all forms of financing including debentures, construction financing, long-term bank loans and lease financing agreements.

4.3. The City will strive to report at minimal annually on metrics similar to those used by credit rating agencies to ensure long-term financial health. Some indicators include:

4.3.1. Debt per capita
4.3.2. Debt charges per capita
4.3.3. Debt charges, as a percentage of Own-Source Revenue
4.3.4. Debt charges, as a percentage of the municipal levy
4.3.5. Debt to operating revenues
4.3.6. Debt to Reserves and Reserve Funds
4.3.7. Cash and liquid assets to operating expenditures
4.3.8. Reserve fund balances in relation to minimum liquidity thresholds

4.4. Debt will be managed in a manner consistent with the City's long-term planning and financial and management objectives as follows:

4.4.1. Total Debt Repayment Limit for all City long term debt, inclusive of any budgeted or proposed debt issue, and which is comprised of the principal and interest component (or of the interest and Sinking or retirement Fund contribution component) for the related debentures, is set at 10% of City own-source revenues.

4.4.2. To monitor and control the impact of debt servicing costs on the approved annual budget of any given year, and in consideration of the impact on future ratepayers, the annual approved capital budget will demonstrate a balanced approach amongst all forms of funding including external debt financing, over a 10 year horizon. Annual debt charges will be the priority draw on available capital funding (development charge or tax funding as appropriate) each year.

4.5. Sufficient development charge revenue shall be held in reserve each year to fund the following year's DC funded debt repayment obligation, to minimize risk to the tax funded budget of any downturn in revenue.

4.6. Issuance of development charge funded debt shall be accompanied by implementation of a plan to eliminate any existing deficit or over-commitment.

4.7. As debt is fully retired on an asset, the amount of revenue used to service the repayment should continue as a transfer to a capital reserve to support the future replacement of the asset. This reduces the need to finance the replacement of the asset through future debt.

5. Limit Financial Risk Exposure

5.1. The capital financing program will be managed in a manner to limit, where practicable, financial risk exposure. As a result, it will be the Corporation's normal practice to issue debt that is only denominated in Canadian dollars with an interest rate that will be fixed over its term.

5.2. Notwithstanding, if a situation arises where there is a material financial advantage and/or it is deemed prudent for the Corporation to issue debt that is subject to fluctuations, in foreign currency and/or interest rates, a hedging strategy will be considered to either reduce or eliminate the risk.

5.3. This strategy would include the following:

5.3.1. For debentures that are not denominated in Canadian currency, the rate of exchange will be fixed for the term of the obligation (both principal and interest payments) on or before the date of issuance.

5.3.2. For variable interest rate debentures with a term exceeding one year, the interest rate will be fixed within six months of the issuance date.

5.4. However, long-term bank loans for which the interest rate may vary will not be fixed if prevailing market conditions are such that in the opinion of the Chief Financial Officer (CFO) / Treasurer it is in the Corporation's best interests to allow the rate to float where such debt, in addition to any other outstanding variable rate loans or debentures, does not exceed 10% of the total outstanding debt of the Corporation as authorized by O.Reg 276/02 s(2).

5.5. Finally, financing leases have different financial and other risks than traditional debt that must be considered and, where practicable, mitigated prior to its use, including:

- Contingent payment obligations for items such as, lease termination provisions, equipment loss, equipment replacement options, guarantees and indemnities.

6. Maintaining the City's / Region's Credit Rating

6.1. Maintaining a superior credit rating is a key factor in minimizing the cost of debt and accessing capital markets in an efficient manner**.** Also, as noted elsewhere, a credit rating of a least AA - (or equivalent) will be needed by the Corporation / Region to meet the statutory requirements for entering into certain types of capital financing contemplated by this policy.

6.2. However, some factors affecting the credit rating are beyond the Corporation's direct control, such as the performance of the economy. To partially mitigate this concern, the Corporation has a Consolidated Reserve Policy (FPDF-004) that ensures its ability to pay operational and financial obligations even if the economy suffers setbacks or other contingencies arise.

6.3. Development charges, which are a major source of funding to repay growth-related debt are particularly sensitive to underlying economic conditions. Having an adequate Development Charge Reserve balance demonstrates to the rating agencies an ability to meet growth-related debt obligations even during periods when collections may temporarily decline.

6.4. Therefore, it will be the Corporation's practice to maintain a cash balance in its Development Charge Reserves equal to a range of 75 to 100 per cent of the projected annual principal and interest payments during the fiscal year for growth related debt.

7. Minimize Long-Term Cost of Financing

7.1. Timing, type and term of debt financing for the approved capital budget will be determined in order to minimize the City's overall long-term cost of financing.

7.2. In order to minimize interest costs over time:

7.2.1. Banker's acceptance and short-term bank loans, which may be issued to bridge finance pending issuance of a debenture, will reduce up-front interest costs on an ongoing basis.

7.2.2. In accordance with Ontario Regulation 247/01, the City may issue variable interest rate debentures, wherein the interest rate is typically lower than a fixed rate debenture.

7.2.3. Long-term bank loans with a variable interest rate and variable interest rate debentures can be left variable if prevailing market conditions are favourable, as approved by the CFO / Treasurer.

7.2.4. Construction financing methods will be considered in accordance with Section 405 of the Act. In advance of the issuance of debentures, shorter term temporary borrowing for capital projects is allowed. The use of rolling short-term financing may be used for a debenture approved capital project. A construction financing debenture may be issued pursuant to which principal and/or interest may be deferred for up to five years as the project is being completed.

7.3. Cost reduction factors which influence the timing and type of debt to be considered by the CFO/Treasurer include:

7.3.1. Timing of costs and revenues related to a project and any offsetting cost savings attributable to a project,
7.3.2. The optimal usage of overall City cash,
7.3.3. Capital reserve fund levels, over minimum balances and the availability of surplus
7.3.4. Reserve fund monies.

8. Suitable and Authorized Financing Instruments

The form of financing that meets the objectives listed above will be dependent in part upon its term and the type of asset to be financed.

8.1. Short-Term – Under One Year

Financing of operational needs for a period of less than one year pending the receipt of taxes and other revenues, or interim financing for capital assets pending long-term capital financing may be from one or more of the following sources:

8.1.1 Reserves and reserve funds. (This may be used as the primary source of short-term financing provided that interest is paid at the prevailing market rate);
8.1.2 Bank line of credit;
8.1.3 Short-term promissory notes;
8.1.4 Bankers' Acceptances; and,
8.1.5 IO (or its successor organizations) short-term advances pending issuance of long-term debentures.

8.2 Long-Term – Greater than One Year

Financing of assets for a period of greater than one year may be from any of the following sources:

8.2.2 Debentures (including those issued to IO or its successor organizations), which may be in the following form or a combination thereof:

8.2.2.1 Installment
8.2.2.2 Sinking fund
8.2.2.3 Term (including those with a refunding provision)
8.2.2.4 Amortizing
8.2.2.5 Variable interest rate
8.2.2.6 Foreign currency
8.2.2.7 Retirement fund

8.3 Reserves and Reserve Funds

8.3.2 These may be used for both interim and medium-term for a period of no greater than five-year financing if deemed cost effective or otherwise necessary.

8.3.3 However, reserves and reserve funds are for a defined purpose and must be available when that purpose occurs or requires them. Notwithstanding this policy, intra-fund borrowing between development charge reserve accounts for a longer period of time is permitted if the funds are available when needed.

8.4 Long-Term Bank Loans (including syndicated bank loans)

8.4.2 These may be used if deemed cost effective or otherwise necessary. These loans may be either fixed or variable interest rate loans as determined by the CFO/Treasurer.

8.5 Construction Financing

May be used for a period up to five 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.

8.6 Lease Financing Agreements (capital financing leases)

May be used when it provides material and measurable benefits compared with other forms of financing. Capital financing leases may include cross-border and rolling stock leases.

8.7 Tile Drainage Debentures

These will be used to finance the construction of tile drainage systems for agriculture and for those individual farmers who apply and are accepted for financing.

9. Notice Period

9.1. The City recognizes that, in order to ensure orderly placement of a Debenture issue within capital markets, York Region requires a lengthy notice period for the issuance of Debentures.

The minimum is 4 to 5 months' notice for the Region, excluding the time required for local Council to approve borrowing bylaw. However, the Region typically sends out an email communication twice a year to survey any debenture requirements as the Region typically issues twice in the capital markets each year. Advanced notice also allows the team, to work with the City to ensure the appropriate borrowing by-law goes before Vaughan's Council.

9.2. The CFO/Treasurer will provide no less than 75 calendar days of official notice, in writing, to York Region regarding City participation in the issuance of Debentures.

10. Roles and Responsibilities:

10.1. The CFO/Treasurer will have the overall responsibility for the capital financing program of the Corporation. The Director, Financial Planning & Development Finance/Deputy Treasurer (Director) normally will have responsibility for directing/implementing the activities of the capital financing program and the establishment of procedures consistent with this policy.

10.2. The Financial Planning & Development Finance department is responsible for developing recommendations and appropriate advice to Council on debt financing decisions and for administer any approved debt financing in conjunction with York Region.

ADMINISTRATION			
Administered by the Office of the City Clerk.			
Review Schedule:	Other (specify) Annual	**Next Review Date:**	November 17, 2021
Related Policy(ies):			
Related By-Law(s):			
Procedural Document:			

Revision History	
Date:	**Description:**
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CITY OF VAUGHAN

PROCEDURE APPENDIX

APPENDIX TITLE: MAXIMUM FINANCING TERM OF AN ASSET

APPENDIX NO.: A

APPENDIX

3 Years
- Computer software
- Police patrol vehicle

4 Years
- General purpose vehicle
- Personal computer and monitors

5 Years
- Mainframe computer/server and network equipment
- Radio and telecommunications system
- Office furnishings
- Audio and Video equipment
- Printers

10 Years
- Specialized vehicle/equipment
- Parking lot
- Public Works facility (depot, dome, etc.)
- Solid waste equipment
- Transit vehicle
- Park, recreational facility
- Dock, wharf, pier, breakwater
- Retaining wall, embankment, flood control
- Sidewalk, path
- Tile drainage
- Street lighting
- Underground wiring

15 Years
Capital Financing and Debt Policy 24
- Police station
- Health clinic
- Library
- Fire station

APPENDIX TITLE: MAXIMUM FINANCING TERM OF AN ASSET

APPENDIX NO.: A

20 Years
- Water main, hydrant, filtration plant, storage facility, pumping station
- Sanitary sewer, storm sewer, treatment plant, pumping station
- Solid waste landfill site
- Home for the aged
- School, other educational building
- Office building
- Hospital
- Dam, reservoir
- Road
- Emergency Medical Services station

Greater than 20 years
- Major infrastructure –only when term approved by Council

30 Years
- Water and wastewater main projects, subject to:

a) the underlying assets having a useful life of at least 30 years; and
b) the project being in receipt of dedicated revenues for a similar period.

- Housing projects, subject to:

a) the underlying assets having a useful life of at least 30 years; and
b) the project being in receipt of dedicated revenues for a similar period.