CITY OF HAMILTON

CORPORATE SERVICES DEPARTMENT
Financial Planning & Policy Division

TO: Chair and Members Audit, Finance and Administration Committee	**WARD(S) AFFECTED:** CITY WIDE
COMMITTEE DATE: October 8, 2013	
SUBJECT/REPORT NO: Debt Management Policy and Lease Financing Policy (FCS13074) (City Wide) (Outstanding Business List Item)	
SUBMITTED BY: Mike Zegarac Acting General Manager Finance & Corporate Services **SIGNATURE:**	**PREPARED BY:** Gerald T. Boychuk (905)-546-4321 Charlie Elliott (905) 546-2424 ext. 2162 Rosaria Morelli (905)-546-2424 ext.1390

RECOMMENDATION

(a) That the Debt Management Policy, attached as Appendix "A" to Report FCS13074, be approved;

(b) That the City of Hamilton Lease Financing Policy (which was approved by Council on February 25, 2004) be deleted and replaced with the Lease Financing Policy, attached as Appendix "B" to Report FCS13074;

(c) That the Lease Financing Policy be forwarded to the Hamilton Police Services Board and the Hamilton Public Library Board for information;

(d) That the Outstanding Business List Item respecting the Debt Policy for the City of Hamilton be considered complete and removed from the Audit, Finance & Administration Committee's Outstanding Business List.

EXECUTIVE SUMMARY

Debt Policy

As part of the Corporate Services' Business Plan to develop a plan on financial sustainability aligned to the City's 2012-2015 Strategic Plan, the General Issues Committee (GIC) approved the following recommendation (Item #12(b) GIC Report 12-033) at its meeting of November 28, 2012:

> *"That staff be directed to develop a formal debt policy for the City of Hamilton and report to the Audit, Finance & Administration Committee."*

As well, Standard and Poor's Rating Service (S&P), during their rating review meeting with the City in 2012, identified a need for the City to have a formal debt policy. The Debt Management Policy (the "Debt Policy"), attached as Appendix "A" to Report FCS13074, meets these requirements.

The Debt Policy is intended to be a comprehensive policy on debt issuance and forms a cornerstone of the City's plan on financial sustainability. The purpose of the Debt Policy is to establish objectives, guidelines and appropriate controls for the use and issuance of debt for the City.

Central to the Debt Policy are the following Objectives:

1. Ensure long-term financial flexibility and sustainability
2. Limit financial risk exposure
3. Maintain the credit rating
4. Minimize long-term cost of financing
5. Comply with statutory requirements including monitoring and reporting

To help achieve these Objectives, the Debt Policy contains the following City-internal goals on debt levels and statutory limits on debt:

<u>City-internal Goals:</u>
1. Total tax and rate-supported debt as a percentage of City Own-Source revenues, **not to exceed 60%,** unless approved by Council.
2. Total Development Charge (DC) supported debt as a percentage of the total DC Eligible Costs for the forecast period of the latest DC Background Study, **not to exceed 25%,** unless approved by Council.

<u>Statutory Limits:</u>
1. The annual debt and financial obligation limit for the City is calculated in accordance with section 3 of *<u>Ontario Regulation 403/02</u>* as amended.

2. Outstanding variable interest rate bank loan agreements and variable interest rate debentures, in total, **cannot exceed 15%** of the total outstanding debt of the City as set out in *Ont. Reg. 276/02 s(2).*

Another key part of the Debt Policy is that it will be reviewed periodically and updated if necessary. Any required changes will then be submitted to Council for approval. Otherwise, the Debt Policy will be formally reviewed, at a minimum of every four years, (from the date of the last review).

There are compelling reasons for Council to approve and the City to adopt the Debt Policy, not least of which, include the following:

- City-internal goals on debt levels and objectives in the Debt Policy help balance the higher levels of debt issuance projected over the medium term to meet infrastructure needs **with** the City's priority for strong creditworthiness.

- In addition to the traditional method of issuing debt, directly in the public markets, the Debt Policy reflects alternative methods of financing (e.g. bank loans and Infrastructure Ontario) that have arisen in the capital markets and are available to the City. The Debt Policy consolidates, provides consistency and guides the applicable use of all the allowed financing methods.

- The Debt Policy incorporates relevant best practices, promotes a common understanding between Council and staff regarding the City's approach to debt issuance and enhances the City's image by demonstrating to the public and rating agencies that the City's debt is well managed.

Lease Financing Policy

As it relates to lease financing agreements – covered in the scope of the Debt Policy - the City of Hamilton's Lease Financing Policy (approved by Council on February 25, 2004) has been revised as the Lease Financing Policy (the "Lease Policy"), attached as Appendix "B" to Report FCS13074.

The Lease Policy has been updated to reflect changes to regulations affecting the policy, including Ontario Regulation 46/94 and Ontario Regulation 799/94, both of which were the basis of the City of Hamilton Lease Financing Policy approved by Council on February 25, 2004, but have since been revoked and replaced by subsequent regulations. The updated Lease Policy is being recommended for approval.

Alternatives for Consideration – Not Applicable.

FINANCIAL / STAFFING / LEGAL IMPLICATIONS (for Recommendation(s) only)

Financial: This report has no financial implications.

Staffing: None.

Legal: None.

HISTORICAL BACKGROUND (Chronology of events)

Debt Policy

The City (and prior to 2001, the Regional Municipality of Hamilton-Wentworth) has maintained a strong credit rating for over 30 years and has been successfully and efficiently issuing debt for over 30 years - traditionally through direct issuance in the capital markets. Nevertheless, the need for a comprehensive debt policy governing the City's debt issuance took shape in 2012 as part of the City's plan to develop a financial sustainability plan.

Chronologically, this need arose also when S&P, during their rating review meeting with the City in July 2012, identified a need for the City to have a formal debt policy. Notably, S&P mentioned the City's (acknowledged) infrastructure deficit backlog of about $2 billion in each of their formal ratings reports of the City since 2011; a consequence of which means a higher debt burden in the medium term.

Shortly thereafter, in November 2012, the City kicked off the implementation of its 2012-2015 Strategic Plan; and specifically, Corporate Services' 2013 Business Plan included the broad task "to develop and implement a Financial Sustainability Plan", which aligns directly with two of the City's Strategic Objectives:

- **Strategic Objective 1.6** Enhance Overall Sustainability (financial, economic, social and environmental) ; and
- **Strategic Objective 2.1** Implement processes to improve services, leverage technology and validate cost effectiveness and efficiencies across the Corporation.

A comprehensive debt policy was to be developed because it forms a piece of this overall plan for financial sustainability.

In November 2012, the General Issues Committee directed staff to develop a formal debt policy (a policy guiding the debt issuance of the City) and to report back to the Audit, Finance and Administration Committee.

Lease Policy

The City of Hamilton's Lease Financing Policy, approved by Council on February 25, 2004, required revision because of changes to regulations affecting the policy, including Ontario Regulation 46/94 and Ontario Regulation 799/94, both of which were the basis for the City of Hamilton Lease Financing Policy approved on February 25, 2004, but have since been revoked and replaced by subsequent regulations.

POLICY IMPLICATIONS/LEGISLATED REQUIREMENTS

The City of Hamilton's Lease Financing Policy (approved by Council on February 25, 2004) has been revised as the Lease Financing Policy (the "Lease Policy"), attached as Appendix "B" to Report FCS13074.

RELEVANT CONSULTATION

City Manager's Office – Legal Services Division has been consulted with respect to the legislative references in the Debt Policy and the Lease Financing Policy.

ANALYSIS / RATIONALE FOR RECOMMENDATION

(include Performance Measurement/Benchmarking Data, if applicable)

Debt Policy

The purpose of the Debt Policy is to establish objectives, guidelines and appropriate controls for the use and issuance of debt for the City. The Debt Policy contains:

- objectives including goals and limits on debt
- legislative requirements
- allowed financial debt instruments and debt structures including their usage
- risk mitigation strategies associated with the financial instruments
- allowed methods of debt issuance
- reporting requirements, authority and responsibilities
- ethics and conflicts of interest for staff involved in debt issuance activities

Objectives of the Debt Policy

The following objectives were developed and articulated to align with the City's 2012-2015 Strategic Plan:

1. Ensure long-term financial flexibility and sustainability
2. Limit financial risk exposure
3. Maintain the credit rating
4. Minimize long-term cost of financing
5. Comply with statutory requirements including monitoring and reporting

Goals and Limits on Debt Issuance

Both City-internal goals on debt levels and legislated limits on debt are central to the Debt Policy and help achieve the Debt Policy objectives:

- Total tax-and-rate-supported debt as a percentage of City Own-Source revenues **not to exceed 60%** unless approved by Council.

  Rationale:

  - ❖ *Currently, this debt ratio is **approximately 20 %***
  - ❖ *In the August 2013 review, S&P highlight certain conditions that may lead to negative implications for the City's rating, one of which is the City total debt (S&P defined, which includes rate, tax **and development charge (DC)** debt) as a percentage of operating revenues (currently at 32%) exceeding 60%. While this criterion alone may not trigger negative implications, the City considers it a prudent goal as it tackles significant capital investment requirements and the associated increase in its debt burden over the medium term. The City forecasts total debt to peak at about $1 billion in 2016, a level which would approach 60% of operating revenues.*

- Total DC-supported debt, as a percentage of the total DC Eligible Costs for the forecast period of the latest DC Background Study, **not to exceed 25%** unless approved by Council.

  Rationale:

  - ❖ *The City considers the limit of 25% to be an appropriate balance between two competing uses of revenues generated by development charges: i) to sustain and ensure adequate infrastructure (capital), services and resources to support the City's growth plans and (ii) to repay the debt issued for development.*
  - ❖ *Currently, this debt ratio is **approximately between 1 and 2%***

- The annual debt and financial obligation limit for the City is calculated in accordance with section 3 of Ontario Regulation 403/02 as amended.

  - ❖ *A Simplified Example- 2013 Annual Repayment Limit (under Ontario Regulation 403/02) for the City as at Dec. 31, 2011, from*

the Ontario Ministry of Municipal Affairs and Housing (MMAH) website, prepared by MMAH on January 10, 2013:
25% of Net Revenues = $283.6 million
Existing Net Debt Charges = $75.5 million
Estimated Annual Repayment Limit = $283.6 million Less $75.5 million = ***$208.1 million***
This says that ***approximately 6%*** *of City Own Source Revenues (Net Revenues above) have been committed to debt service charges, which are limited to a maximum of 25% of City Own Source Revenues. Alternatively, the Estimated Annual Repayment Limit of $208.1 million corresponds to the City having debt capacity to issue* ***up to $2.2 billion*** *(assuming 15 year maturity and 5% interest rate) in new debt.*

- Outstanding variable interest rate bank loan agreements and variable interest rate debentures, in total, **cannot exceed 15%** of the total outstanding debt of the City as set out in O. Reg. 276/02, s. 8(2).
    - ❖ Currently this debt ratio is **slightly below 15%**

Numerous other legislative and City specific requirements, contained in the Debt Policy, help the City achieve Debt Policy Objectives. For example, the Debt Policy includes certain financial ratios related to debt levels that monitor debt affordability and sustainability; credit rating requirements; and strategies to mitigate risk for variable rate, foreign currency and construction financing debentures and for variable interest rate bank loan agreements.

The Debt Policy will be reviewed periodically and updated, if necessary, and any required changes will then be submitted to Council for approval. Otherwise, the Debt Policy will be formally reviewed, at a minimum of every four years (from the date of the last review), which is the standard review period for policies at the City.

Other Municipality Comparisons and Research:
In developing the Debt Policy, staff used the debt policies of the City of Toronto, Regional Municipality of Peel and Regional Municipality of York which were obtained online. Staff used the City of Ottawa's Administration of Capital Financing and Debt Policy obtained from the City of Ottawa. Staff also reviewed the Government Finance Officers Association (GFOA) Best Practice on Debt Management and the Recommended Practice on Debt Management by the GFOA Committee on Canadian Issues Best Practices and Advisories.

Lease Policy

Lease finance agreements are included in the scope of the Debt Policy as another form of debt. The Lease Policy has been updated to reflect changes to regulations affecting the policy, including Ontario Regulation 46/94 and Ontario Regulation 799/94, both of which, were the basis of the City of Hamilton Lease Financing Policy that was approved by Council on February 25, 2004, but have since been revoked and replaced by subsequent regulations. **There were no substantive changes to the content of either regulations affecting the policy.**

ALTERNATIVES FOR CONSIDERATION

(include Financial, Staffing, Legal and Policy Implications and pros and cons for each alternative)

None.

ALIGNMENT TO THE 2012 – 2015 STRATEGIC PLAN:

Strategic Priority #1
A Prosperous & Healthy Community

WE enhance our image, economy and well-being by demonstrating that Hamilton is a great place to live, work, play and learn.

Strategic Objective
1.6 Enhance Overall Sustainability (financial, economic, social and environmental).

Strategic Priority #2
Valued & Sustainable Services

WE deliver high quality services that meet citizen needs and expectations, in a cost effective and responsible manner.

Strategic Objective
2.1 Implement processes to improve services, leverage technology and validate cost effectiveness and efficiencies across the Corporation.

APPENDICES / SCHEDULES

Appendix “A” to Report FCS13074 – Debt Management Policy – City of Hamilton
Appendix “B” to Report FCS13074 - Lease Financing Policy – City of Hamilton

DEBT MANAGEMENT POLICY

CITY OF HAMILTON

CONTENTS

I. INTRODUCTION

1.01 Purpose
The Debt Management Policy (the “Debt Policy”) provides guidelines and a framework for the issuance of bonds and other forms of indebtedness for the City of Hamilton (the “City”). The Debt Policy contains written objectives, allowances and restrictions (including applicable statutory requirements) for the debt issuance process and the management of debt.

1.02 Scope
The Debt Policy covers all debt or financial obligations including related agreements and lease financing agreements for capital that are entered into by the City as well as those employees who are responsible for the City’s debt issuance activities. Lease financing agreements entered into by the City must be undertaken in accordance with the City’s Lease Financing Policy as approved by Council (the “Lease Policy”).

The City may issue a debenture or other financial instrument for long-term borrowing only to provide financing for a capital work (Municipal Act, 2001, s. 408(2.1)). The types of capital projects are as follows:

- <u>Growth/Development-Charge</u>

Issuance of growth related debt may be undertaken in order to ensure adequate infrastructure or capital, services and resources to support the City’s growth plans. Repayment of this type of debt (principal and interest) shall be recoverable through the City’s development charges (DC).

- <u>Growth/Non-Development-Charge</u>

Other assets or capital works considered to be growth related, but not deemed to be funded through development charges can be funded using debt. This debt would be funded primarily from taxes, water and wastewater user rates and/or reserves.

- <u>Non-Growth Replacement</u>

To the extent practicable, replacement assets as well as regular and/or ongoing capital expenditures will be funded on a “pay as you go” basis through water and wastewater rates, tax levy, user fees and/or reserve monies.

- <u>Non-Growth</u>

The City may also incur debt for other new capital related to the delivery of services that is not considered to be ‘growth’ in nature.

1.03 Definitions
In the Debt Policy, the following terms have the following meanings:

“amortizing debenture”: A debenture that has a blended principal and interest payment that is equal in each repayment period.

“Annual Repayment Limit”: A calculation, of the debt and financial obligation limit, provided annually to a municipality by the Ministry of Municipal Affairs and Housing that determines whether Ontario Municipal Board approval is required for the categories of debt or financial obligation described in Ontario Regulation 403/02 as amended.

“bank loan”: A loan made by a bank listed in Schedule I or II or III to the *Bank Act* (Canada), a loan corporation or trust corporation registered under the *Loan and Trust Corporations Act* or a credit union or league to which the *Credit Unions and Caisses Populaires Act, 1994* applies and includes, (a) a syndicated bank loan, and (b) a banker’s acceptance, whether or not it is discounted, if, (i) it is drawn as a bill of exchange under the *Bills of Exchange Act* (Canada), and (ii) it is accepted by a bank to which the *Bank Act* (Canada) applies.

“borrower”: The counterparty receiving the funds.

“banker’s acceptance”: A short-term credit obligation created by a non-financial firm such as the City and guaranteed by a bank as to payment.

“bond forward agreement”: A financial contract with an eligible Schedule I, II or III bank used to hedge future interest rates by short selling a particular Government of Canada or Province of Ontario bond and repurchase the same bond at a predetermined future settlement date. A settlement payment may be required by either the issuer or the bank if there is a difference between the price at which the government debt instruments are sold and the price at which they are bought back on the settlement date.

“bought deal”: A financing transaction, such as a debenture issue, in which an individual underwriter or underwriting group purchases the entire amount in order to re-sell to investors.

“capital financing”: A generic term for the financing of capital assets. Although this can be achieved through the use of a variety of funding sources, for the purposes of the Debt Policy it is assumed to mean the use of debt.

“construction financing”: A form of debt financing in which the issuer does not pay any principal and/or interest for periods of normally up to 5 years during the construction or rehabilitation of the facility.

“City”: the City of Hamilton.

“City Own-Source Revenue” – is equal to “Net Revenues” per Financial Information Return (FIR) Schedule 81, Annual Debt Repayment Limit, Line 2610. The calculation of Net Revenues is basically Total City Revenues less revenues from Federal & Provincial Grants and Gas Tax, Development Charges, Parkland Dedication, and Donated Tangible Capital Assets.

“Council”: the council of the City of Hamilton.

“credit rating”: A rating assigned by a credit rating agency (such as Standard and Poor’s or Moody’s Investors Service, Inc. or Dominion Bond Rating Service Limited or Fitch Ratings) recognized by the *Municipal Act, 2001*, S.O. 2001, c. 25 as to the credit worthiness of an entity’s debt obligations. The rating defines the financial strength of a borrower and assists investors to determine the likelihood that the debt issuer will pay the interest payments in a timely fashion and more importantly the initial investment at maturity.

“debenture”: A formal written obligation to repay specific sums on certain dates. In the case of a municipality such as the City of Hamilton, debentures are typically unsecured.

“annual debt and financial obligation limit”: A calculation of the debt and financial obligation limit, provided annually to a municipality by the Ministry of Municipal Affairs and Housing that determines whether Ontario Municipal Board approval is required for the categories of debt or financial obligation described in Ontario Regulation 403/02 as amended.

“debt service charges”: the amount corresponding to annual debt and financial obligations.

“debt”: Any obligation for the payment of money. For Ontario municipalities, debt would normally consist of debentures as well as either notes or cash loans from financial institutions, but could also include loans from reserves.

“deemed debentures”: A bank loan agreement is deemed to be a debenture for the purpose of the following provisions of the Municipal Act, 2001, as set out in O. Reg. 276/02, s. 5: Section 403; Subsections 404(1) to (8) and Subsections 404(10) to (14);

Subsections 405(2); Section 406; Subsections 408(2.1) and (3), clauses 408(4)(a), (c) and (d), and subsections 408(5) and (7); Subsections 412 (2) and (4).

“development charge”: (DC) Fees collected from developers at the time a building permit is issued. The fees are charged for the cost of infrastructure required to provide municipal services to new development, such as roads, transit, water and sewer infrastructure, community centres and fire and police facilities.

“DC Eligible Costs”: are growth related costs for certain services as defined by the Development Charges Act.

“DC Background Study”: is a document required by the Development Charges Act to identify service needs arising from residential and non-residential growth and the associated eligible costs, in order to calculate the Development Charge rates charged by the City.

“financial guarantee”: An agreement whereby the City will take responsibility for the payment of debt in the event that the primary debtor fails to perform.

“financial lease”: A financial arrangement whereby equipment or municipal capital facilities are provided to the City by a third party in exchange for a series of payments that extend beyond the term for which Council was elected (includes renewal options).

“foreign currency debentures”: Debentures which are expressed and payable in a foreign currency.

“foreign currency exchange agreements”: An agreement entered into with a financial institution to fix the rate of exchange for future payments made in a foreign currency.

“City Treasurer”: the Treasurer of the City of Hamilton.

“hedging”: A strategy used to offset or mitigate financial risk such as currency and/or interest rate risk.

“Infrastructure Ontario (formerly Ontario Strategic Infrastructure Financing Authority (OSIFA) or its successor organizations)”: A crown corporation wholly owned by the Province of Ontario and established by the Ontario Infrastructure and Lands Corporation Act, 2011. Infrastructure Ontario provides Ontario municipalities, universities and hospitals access to an alternative financing service for longer-term fixed rate loans for the building and renewal of public infrastructure.

“instalment (serial) debentures”: Debentures of which a portion of the principal matures each year throughout the life of the debenture issue.

“interest rate exchange agreement”: An agreement entered into with a financial institution to fix the future rate of interest paid on a variable interest rate debenture or variable interest rate bank loan agreement.

“lease financing agreement”: A financial arrangement, including a material lease or a non-material lease, whereby equipment or municipal capital facilities are provided to the City by a third party in exchange for a series of payments that may extend beyond the term for which Council was elected (includes renewal options).

“letter of credit”: A binding document from a bank guaranteeing that a buyer’s payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make payment on the purchase, the bank will be required to cover the full or remaining amount of the purchase (debt).

“long-term bank loan”: Long-term debt provided by a bank or a syndicate (group) of banks.

“long-term debt or financing”: Any debt for which the repayment of any portion of the principal is due beyond one year.

“material lease”: A lease financing agreement which extends beyond the term of Council which requires annual payments of $150,000 or more or a lease term of more than five years for commercial real property.

“municipal capital facilities”: Includes land, as defined in the *Assessment Act*, works, equipment, machinery and related systems and infrastructures.

“non-material leases”: A lease financing agreement which requires annual payments of less than $150,000 annually with a lease term of less than 5 years.

“retirement fund debentures”: Debentures for which funds are accumulated on a prescribed basis, commencing one year after the issuance of the debentures, in a separate custodial account, the sum total, including interest earned, is used to fund the redemption of the debentures.

“short-term debt”: Any debt for which the repayment of the entire principal is due within one year.

“sinking fund”: A fund in which money is accumulated on a regular basis that when combined with interest earned is used to retire or repay the debentures on maturity.

“sinking fund debentures”: A long-term debt instrument that contains a sinking fund provision that the issuer has undertaken to regularly set aside on a fixed date funds to a sinking fund for the repayment of the principal at maturity.

“syndicated bank loans”: A bank loan between the City and an institution listed in the definition of “bank loan” where the financing for the bank loan is obtained through a syndicated bank financing agreement in which each of the institutions that is a party to the term agreement agrees to contribute a portion of the amount of the bank loan being given to the City under the syndicated bank loan agreement.

“tax and rate supported debt”: Debt which is supported by the tax levy and by utility charges and fees.

“development-charge supported debt”: Debt which is supported by development charges.

“tender”: A process whereby formal bids are submitted to issue debt securities or to provide a lease.

“term debentures”: Debentures that are comprised of a combination of instalment and sinking fund debentures.

“tile drainage debentures”: Debentures issued to the Province of Ontario to finance the construction of a tile drainage system for agricultural land in accordance with the Tile Drainage Act, R.S.O. 1990, c. T.8.

“ underwriter(s)”: An individual or group of investment bankers appointed as principals or on an agency basis, for the purpose of purchasing and reselling new debentures issued by the City.

“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 debenture.

II. OBJECTIVES

The objectives of the Debt Policy are as follows:

1. Comply with statutory requirements including monitoring and reporting;
2. Ensure long-term financial flexibility and sustainability;
3. Limit financial risk exposure;
4. Minimize long-term cost of financing;
5. Maintain the City’s credit rating.

2.01 Compliance with Statutory Requirements

Debt may only be undertaken by the City if and when it is in compliance with the relevant sections of the *Municipal Act, 2001*, S.O. 2001, c. 25 (the “Municipal Act, 2001”), specifically Part XIII – Debt and Investment, and the applicable regulations thereunder, as amended from time to time, including but not limited to those set out in the References section of this Debt Policy.

The City may incur a debt for municipal purposes, whether by borrowing money or in any other way, and may issue debentures and prescribed financial instruments and enter prescribed financial agreements for or in relation to the debt (Municipal Act, 2001, s. 401(1)).

2.02 Ensure Long-Term Financial Flexibility and Sustainability

The City’s ability to respond to unanticipated and emerging financing needs is affected by its access to funding, its debt capacity and debt service charges. Financial sustainability depends on the debt levels and debt service charges being consistent with the City’s level of affordability, both current and future. Debt issuance decisions must align with ensuring long-term financial flexibility and sustainability for the City.

Goals and limits on debt, and financial measures to assist in assessing financial flexibility and sustainability are as follows:

Goals

- Total tax-and-rate-supported debt as a percentage of City Own-Source Revenues not to exceed **60%** unless approved by Council.
- Total DC-supported debt as a percentage of the total DC Eligible Costs for the forecast period of the latest DC Background Study, not to exceed **25%** unless approved by Council.

Limits

- The annual debt and financial obligation limit for the City is calculated in accordance with section 3 of Ontario Regulation 403/02 as amended.
- Outstanding variable interest rate bank loan agreements and variable interest rate debentures cannot exceed **15%** of the total outstanding debt of the City as set out in O. Reg. 276/02, s. 8(2).

Financial measures

- Debt and debt service charges per capita
- Debt service charges as a percentage of City Own Source Revenue
- Debt service charges as a percentage of the municipal levy
- Debt to operating revenues
- Debt to reserves and reserve funds
- Debt maturity profile
- Cash and liquid assets to debt service; cash and liquid assets minus debt
- Other long-term liabilities
- Annual increase in debt in relation to population, assessment growth, operating revenue, average household income

2.03 Limit Financial Risk Exposure

Debt will be managed in a manner to limit, where practicable, exposure to interest rate risk, foreign currency risk, financial risk associated with entering into financial leases, and any other financial risks which may arise from the debt financing.

- The City's normal practice to issue debt that is only denominated in Canadian dollars with an interest rate that is fixed over its term
- If there is a material financial advantage and/or it is deemed prudent for the City to issue foreign currency debentures (debt that is subject to fluctuations in foreign currency and not denominated in Canadian currency), then the rate of currency exchange will be fixed for the term of the obligation (both principal and interest payments) on or before the date of issuance.
- Similarly, if there is a material financial advantage and/or it is deemed prudent for the City to issue variable rate debentures or enter into variable interest rate bank loan agreements, the interest rate can be left variable if in the opinion of the City Treasurer it is in the City's best interest.
- Lease finance agreements have different financial and other risks compared to traditional debt that must be considered, and where practicable mitigated prior to

their use. The City’s Lease Policy identifies these risks and all requirements that must be met before entering into a lease financing agreement.

2.04 Minimize Long-Term Cost of Financing

The type, term and structure of financing instrument used to issue debt and the timing for debt issuance will be determined with a view to minimize both its and the City’s overall long-term cost of financing. Factors to be considered include the following:

- current versus future expected interest rates;
- the shape of the interest rate curve;
- the availability of related reserve monies;
- the pattern of anticipated revenues or cost savings attributable to the project or purpose;
- the applicability of using bond forward agreements;
- all costs related to the financing of the project whether by debenture, construction financing or lease financing agreement;
- the use of Banker’s acceptances to bridge finance pending issuance of a debenture, and may reduce up-front interest costs on an ongoing basis;
- variable interest rate debentures;
- variable interest rate bank loan agreements.

2.05 Maintain the City’s Credit Rating

Maintaining a strong credit rating is a key factor in minimizing the cost of debt and accessing capital markets in an efficient manner. Moreover, as noted elsewhere, a credit rating of at least AA- (or equivalent) is needed by the City to meet statutory requirements to enter into certain types of financing or debt instruments contained in the Debt Policy.

III. DEBT INSTRUMENTS AND STRUCTURING PRACTICES

3.01 Suitable and Authorized Financing Instruments

The types of allowed (debt) financing instruments and their structures will be dependent in part upon the term and the type of asset to be financed.

a) Short-Term Debt – Less Than One (1) 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 financing may be from one or more of the following sources:

- Reserves and reserve funds. An internal loan from reserve funds to finance capital projects must be in accordance with the City’s Reserve Policies and must be approved and authorized by Council; a recommendation report requesting authorization should contain the details pertaining to the loan including amount, term, interest rate and any other relevant details.
- Bank line of credit or loan agreement
- Short-term promissory notes
- Banker’s Acceptances
- Infrastructure Ontario (or its successor organizations) short-term advances pending issuance of long-term debentures

b) Long-Term Debt - Greater Than One (1) Year

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

i) <u>Debentures (including those issued to Infrastructure Ontario, or its successor organizations), which may be in the following form or a combination thereof:</u>
   - Instalment/Serial
   - Sinking Fund
   - Amortizing
   - Variable Interest Rate
   - Foreign Currency (in the currencies prescribed by O. Reg. 247/01, Sched.)
   - Retirement Fund
   - Term

ii) Reserves and Reserve Funds

An internal loan from reserve funds to finance capital projects must be in accordance with the City’s Reserve Policies and must be approved and authorized by Council; a recommendation report requesting authorization should contain the details pertaining to the loan including amount, term, interest rate and any other relevant details. Normal practice would be for a term or a period of less than or equal to fifteen years.

iii) Bank loan agreements, variable interest rate bank loan agreements, syndicated bank loan agreements.

iv) Lease Financing Agreements

Leases may be used to finance equipment, buildings, land or other assets that the City does not have a long-term interest in or may not be able to acquire through other means, and when they provide material and measurable benefits compared with other forms of financing.

v) Construction Financing Debentures

- May be used for a period up to five (5) 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.
- Should the City pass a debenture by-law which provides that instalments of principal or interest, or both, are not payable during the period of construction of an undertaking for which the debt was incurred, then the City shall only do so in accordance with the requirements of O. Reg. 278/02 (Construction Financing).

vi) 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.

c) Debt Structures

- Debt issues are structured to achieve the lowest possible all-in net cost of funds, subject to constraints of debt maturity, the capital asset being financed, prevailing capital market conditions and the objectives of the Debt Policy.
- The term of a debt of the City or any debenture or other financial instrument for long-term borrowing issued for it shall not extend beyond the lifetime of the capital work for which the debt was incurred and shall not exceed 40 years (Municipal Act, 2001, s. 408(3)).

- To the extent possible, debt will be structured to require repayment as soon as feasible so as to recapture its borrowing capacity for future use and minimize costs where possible.
- The principal must be amortized (repaid) over the term of the debenture and repaid to investors or contributed to a sinking fund that would provide for repayment when the debt matures.
- A by-law that authorizes a bank loan agreement shall provide for repayment of the principal and the interest on the unpaid balance in one or more instalments in each year. O. Reg. 276/02, s. 2(2).
- For variable rate debentures and variable interest rate bank loan agreements, the City may employ interest rate exchange agreements to fix the variable interest rate.
- To issue foreign currency debentures, the City must enter into one or more foreign currency exchange agreements for the debenture on or before the date it issues the debenture to convert the foreign currency principal and interest payments to Canadian currency payments. This must be done in accordance with the requirements of O. Reg. 247/01.
- Every debenture issued by the City shall rank concurrently and equally in respect of payment of principal and interest with all other debentures of the City (Municipal Act, 2001, s. 408(7)).

d) Credit Rating Requirements

The City may only issue foreign currency debentures or variable interest rate debentures, and may enter into a variable interest rate bank loan agreement or into a syndicated bank loan agreement only if either the City itself or its long-term debt obligations are rated by:

- Dominion Bond Rating Service Limited as “AA(low)” or higher, or
- Moody’s Investors Service, Inc. as “Aa3” or higher, or
- Standard and Poor’s as “AA-“, or higher, or
- Fitch Ratings as “AA-“, or higher.

O. Reg. 276/02, s. 9, O. Reg. 247/01, s. 5, s. 9(b)

3.02 Financing Risk Identification and Mitigation Strategies

Financial risks associated with financing instruments will be identified and considered prior to the use of the financing instrument in relation to other available financing instruments, and strategies to mitigate the risk will be considered and used when deemed practicable.

a) Availability of Future Debt Capacity

The City recognizes the importance of maintaining availability of debt capacity for future capital needs and to ensure long-term financial flexibility. Accordingly, the tax and rate supported budget documents show the projected amount of debt financing that may be required for each year over a ten year forward looking period so as to evaluate future debt capacity and the impact on the City’s financial flexibility and sustainability.

b) Refunding Risk

The City may issue debentures for which the amortization to retirement period is longer than the contractual term of the debenture, similar to a home mortgage, resulting in the balance of the debt remaining at the end of the contractual term to be refinanced.

The risk would be that interest rates may be higher during the second financing period, resulting in higher than anticipated debt payments. For this reason the use of refunding debentures will not be a preferred method of financing by the City whenever tax levy is the primary source of funding. However there will be no restriction to the use of refunding debentures funded mainly from development charges or user rates which tend to be for longer periods and are better able to absorb increases (or decreases) to their cost of financing over time.

Further risk to the City may arise if market conditions are unfavorable to financing at the end of the first contractual term of a refunding debenture. In this case, mitigation strategies that would be considered include pre-financing, short-term borrowing from reserves, using variable rate debt and lines of credit, and making borrowing applications to government and government agencies such as Infrastructure Ontario (or its successor organizations).

c) Construction Financing

Construction financing may be used to “lock-in” the debt needed for a capital project that will eventually generate a revenue stream which could be used to make principal and interest payments (e.g. water plant). Construction financing is unique in that the debt may be accrued in advance of the project’s completion; the interest accrues and no payments are made during the building period.

The following risks compared to other forms of financing will be considered prior to the use of construction financing:

- The possibility that interest rates may fall from the time the rate for the construction loan is established and completion of construction. Should there be a high probability of this occurring, staff will consider the use of variable interest rate rather than fixed rate financing as a method to mitigate this risk;

- The possibility that the final cost of construction could be materially less than initially forecasted and financed. Staff will consider whether or not to issue debt until a fixed rate contract has been awarded or to issue debt that does not exceed 75% of the projected cost as a method to mitigate this risk.

- Other risks include that the construction project may not be able to proceed or is not completed for technical or other reasons. The mitigation option to be considered in this case will be not to issue long-term debt until all critical construction contracts have been awarded.

The City Treasurer will prepare a statement of policies and goals related to construction financing, which must be adopted by Council before a by-law is passed that provides for construction financing. The statement shall include the following:

- The fixed and estimated costs to the City;
- Whether the costs of the proposed construction financing are lower than other methods of financing available to the City;
- A detailed estimate with respect to the terms of the City’s expectations of revenue generation from the undertaking, once constructed;
- The risks to the City if the undertaking is not constructed or completed within the period of construction as estimated by Council; and
- The financial and other risks for the City.

(O. Reg. 278/02, s. 2)

d) Lease Financing Agreements

Risks arising from lease financing agreements compared to other forms of financing will be considered prior to their use. These risks are outlined in the City’s Lease Policy.

e) Variable Interest Rate Debenture and Variable Interest Rate Bank Loan Agreements

Variable interest rate debentures and variable interest rate bank loan agreements may be used when there is volatility in the financial market and/or there is an expectation of significantly lower interest rates occurring within a few months of their issue or if it is financially advantageous or otherwise deemed necessary.

The interest rate may be left variable if in the opinion of the City Treasurer it is in the City’s best interest. A variable interest rate may be converted to a fixed rate by means of an interest rate exchange agreement in order to mitigate the interest rate exposure.

The City cannot enter into a variable interest rate bank loan agreement if the total amount of principal to be loaned under the agreement plus the total outstanding principal of all other variable interest rate bank loan agreements and variable interest rate debentures of the City would exceed 15% of the total outstanding principal of all undertaking or work indebtedness of the City plus the total amount of principal to be loaned under the bank loan agreement (O. Reg. 276/02, s. 8).

f) Foreign Currency Debentures

Foreign currency debentures may be used when the “all in” cost of financing in a foreign market is cheaper or the market conditions are such that domestic financing is not practicable. The risk associated with foreign currency debentures is that the rate of currency exchange incurred for future interest and principal payments could significantly increase over the term of the debt, raising its overall cost. This risk is mitigated by legislation which requires a foreign currency debenture to have the rate of exchange for all interest and principal payments fixed prior to its issue by means of a foreign currency exchange agreement. The foreign currency exchange agreement for a debenture shall, when read together, provide for the reduction of currency risk with respect to the entire amount of principal and interest payable under the debenture and shall require any amount payable to any person under the agreement or agreements to be expressed as a Canadian currency amount.

g) Bond Forward Agreements

The timing and interest rate of a City’s debenture issue is dependent upon market or economic conditions prevailing at the time of each issue, which may include unfavourable market conditions due to issuance calendars and in times of financial crisis. Therefore the City is exposed to changes in interest rates until a planned debenture issue is launched. Bond forward agreements would allow the City to lock-in the underlying interest rate of a planned debenture issue, which would facilitate the issuing process and reduce the risk of changes in interest rates.

IV. DEBT ISSUANCE PRACTICES

4.01 Methods Used to Issue Debt

a) Sale Method for Debentures Issued in the Public Markets

- Underwriting Syndicate : The use of an underwriting syndicate will be the normal method by which debentures will be sold by the City;
- Tender: A tender process may be used when and if significant savings could be expected when compared to issuing through an Underwriting Syndicate.;
- Bought Deal/Private Placement: This may be appropriate for only “one off” or unusual financing structures when significant savings would be expected or when market conditions are volatile or otherwise difficult.

b) Bank Loan Agreements

Bank loan agreements are deemed to be debentures. Variable interest rate bank loan agreements have a variable interest rate.

c) Debentures Issued Through Other Levels of Government

The City may issue debentures to Infrastructure Ontario or its successor organizations. In general, when evaluating whether to participate in a loan or debt program being offered by the federal government or the government of Ontario, the interest rate and terms would be compared with the City’s all-in cost of borrowing for other methods under consideration.

d) Financial Guarantees and Letters of Credit

Financial guarantees and/or letters of credit provided by the City will be considered as debt and will be governed by the Debt Policy.

e) Debt Retirement Reserve Fund

Council may authorize contribution to a debt retirement reserve or reserve fund to fully or partially fund the purchase of outstanding debt prior to its maturity to offset the funding requirements related to debt. Investments for the debt retirement reserve fund would be made in accordance with the City’s Statement of Investment Policies and Procedures (SIP&P) for Reserve/Revenue Funds.

f) Sinking Fund

A sinking fund will be established whenever sinking fund debentures are issued during a calendar year. Investments for the sinking fund would be made in accordance with the City’s SIP&P for Reserve/Revenue Funds.

4.02 City’s Process for Issuing Debentures and/or Bank Loan Agreements

Approval by Council is required to authorize the issuance of debentures and/or a bank loan agreement, and the general process for the City is as follows:

a) The City Treasurer through a Recommendation Report to Council:

- Requests authorization to negotiate the terms and placement of a debenture issue(s) and/or bank loan agreement in an amount to finance capital projects or for any short term loans for operations.
- Requests authorization to engage the services of a fiscal agent(s) and extermal legal counsel and enter into all agreements necessary, including Letter(s) of Representation with the Canadian Depository for Securities Ltd, to secure the terms and issuance of a debenture issue(s).
- Is directed by Council to negotiate and execute all required documentation, in a form satisfactory to the City Solicitor
- Recommends that a by-law be passed authorizing the debenture issue and/or bank loan agreement, which was negotiated and placed.
- Provides the details and rationale that justify the financing including the chosen structure of debt, an evaluation of the other financing options that were considered and a comparison of the costs.

b) The City Treasurer prepares the required final legal documentation and arranges for its execution and decides on the timing of the debt closing.

c) Subsequent to the closing of a debenture issue or bank loan agreement or another debt, the City Treasurer shall present to Council a report with details of the financing including the structure of the debenture and/or bank loan agreement, , final monies raised, term to maturity, interest rate and cost savings compared with other forms of financing that were considered and any other relevant details.

4.03 Investment of Debt Issuance Proceeds

Funds raised through debt issuance activities will be invested in accordance with the City’s SIP&P for Reserve/Revenue Funds until such time as the funds are required.

V. DEBT MANAGEMENT PRACTICES

5.01 Ethics and Conflicts of Interest

City staff that are involved in the debt issuance process are expected to abide by the City’s Code of Conduct for Employees Policy. In particular, they shall:

- Refrain from personal business activity that could conflict with the proper execution and management of financing activities or that could impair their ability to make impartial decisions;
- Disclose any material interests in financial institutions with which they conduct business;
- Disclose any personal financial/investment positions that could related to the performance of their financing activities; and
- Not undertake personal financial transactions with the same individual with whom business is conducted on behalf of the City.

5.02 Requirements for Outside Advice

The City’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 debt issuance transactions that are unusually complicated or non-standard, or as otherwise directed, outside financial and/or legal advice will be obtained.

5.03 Legal Support

A specific borrowing by-law must be adopted by Council to authorize the borrowing through the issuance of debentures and/or the entering into a bank loan agreement for the purpose of capital financing that is covered by this Debt Policy.

The Legal Services Division provides legal advice with regard to the City’s debt financing transactions and legal advice may also be obtained from external legal counsel. This advice would cover the initial proposal and extend to the various contracts and agreements that would have to be executed in conjunction with the transaction.

External legal counsel is retained by the City to provide a legal opinion on the transaction. The Legal Services Division works closely with external legal counsel. It is the responsibility of the issuer (i.e. the City) to bear the full costs associated with the transaction.

5.04 Authority to Issue Debt

Council shall, before giving authorization for capital work that would require a long-term debt or financial obligation, have the City Treasurer calculate an updated Annual Repayment Limit using the most recent Annual Repayment Limit determined by the Ministry. O. Reg. 403/02, s. 4 (1). The City Treasurer must submit to Council a report requesting authority to issue debt, for instance in any of the following cases:

- To undertake 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;
- To issue debt for certain items detailing for each type of item, the amount and the maximum term of financing, the type of instrument and structure used for the debt issuance or financing.
- To issue debt or finance for sinking fund purposes in that year.

5.05 Reporting Requirements

<u>Financial Lease Agreements:</u>

Reporting requirements for lease financing agreements entered into by the City are contained in the City’s Lease Policy.

<u>Construction Financing:</u>

If the City has any outstanding debentures related to construction financing under clause 408 (4) of the Municipal Act, 2001, in a fiscal year, the City Treasurer shall present to Council once in that fiscal year, or more frequently, if Council so provides, a detailed report on all those debentures, containing the following:

- A description of the proportion of the construction financing debentures issued to the total long-term debt of the City and a description of the change, if any, in that estimated proportion since the previous year’s report;
- A statement by the City Treasurer as to whether, in his or her opinion, all debentures issued were made in accordance with the statement of policies and goals relating to construction financing adopted by Council;
- An update of the detailed estimate with respect to the terms of the City’s expectations of revenue generation from the undertaking;
- A record of the date of the repayment of each instalment of principal, interest or both principal and interest made during the period of construction and during the term of the debentures;

- A statement of the outstanding instalments of principal, interest or both principal and interest repayable during the currency of the debentures issued that will be due and payable in each year;
- Any such other information that Council may require or that in the opinion of the City Treasurer should be included.

<u>Bank Loans:</u>
If the City has any subsisting variable interest rate bank loan agreements in a fiscal year, or any subsisting interest rate exchange agreements applicable to them, the City Treasurer shall present to Council once in that fiscal year, or more frequently if Council so desires, a detailed report on all those bank loan or interest rate exchange agreements. O. Reg. 276/02, s. 12.

<u>Variable Interest Rate Debentures and Foreign Currency Borrowing:</u>
If the City has any outstanding variable interest rate debentures or foreign currency debentures in a fiscal year, or any subsisting interest rate or foreign currency exchange agreements applicable to them, the City Treasurer shall present to Council once in that fiscal year, or more frequently if Council so desires, a detailed report on all those debentures or agreements. O. Reg. 247/01, s. 12.

<u>Bond Forward Agreements</u>
If the City has entered any bond forward agreements in a fiscal year, the City Treasurer shall present to Council once in that fiscal year or more frequently if Council so desires a detailed report on all the bond forward agreements including the following information and documents:

- A statement comparing the expected and actual results of using bond forward agreement during the period of the report.
- A statement by the City Treasurer indicating whether, in his or her opinion, all of the bond forward agreements entered during the period of the report are consistent with the City’s statement of policies and goals relating to the use of bond forward agreements.
- Such other information as Council requires or as the City Treasurer considers appropriate to include in the report.
  O. Reg. 653/05, s. 4(1) , s. 4(2)

All the above include in addition any such information as the Council may require and such other information as the City Treasurer considers appropriate to include in any of the reports.

5.06 Responsibilities

Council: Overall responsibility for authorizing debt issuance.

The City Treasurer: Responsibility for directing and implementing the activities of debt issuance including but not limited to:

- Review and recommend the type and term of financing for capital projects and operating requirements.
- Update the debt and financial obligation limit for the City as prescribed by the Municipal Act, 2001;
- In consultation with the underwriting syndicate, approves the timing and structure of debt issues;
- Coordinates the preparation of debt issue by-laws ;
- May execute and sign documents on behalf of the City and perform all other related acts with respect to the issuance of debt securities;
- Liaises and assists credit rating agencies in the evaluation of the credit worthiness of the City’s debt securities;
- Reviews and recommends to Council the financial and business aspects of any material lease financing agreements and transactions;
- Ensures all reporting requirements identified within the Debt Policy are met; and
- Signs required documentation under the Municipal Act, 2001.

Chair of Council: The Chair of Council may execute and sign documents on behalf of the City with respect to the issuance of debt securities and shall sign debentures.

Clerk: The Clerk may certify and sign documents on behalf of the City with respect to the issuance of debt securities.

5.07 Debt Policy Review

The Debt Policy will be reviewed periodically by the City Treasurer. Any required changes shall then be submitted to Council for consideration and approval. Any changes or revisions to the *Municipal Act*, *2001*, or to the regulations thereunder subsequent to the formal adoption of the Debt Policy which affect the policy will apply when they come into force. The Debt Policy will be updated to reflect such change(s) at the time of formal review. Otherwise, the Debt Policy must be formally reviewed and approved by Council at a minimum every four years (from the date of the last review).

VI. USE OF DERIVATIVES

6.01 Interest Rate Exchange Agreements:

If the City has issued or plans to issue a variable interest rate debenture, it may enter interest rate exchange agreements for the debenture. (O. Reg. 247/01, s. 4(1)) Similarly, if the City has issued or plans to issue a variable interest rate bank loan agreement, it may enter interest rate exchange agreements for the bank loan agreement (O. Reg. 276/02, s. 10) The interest rate exchange agreement would fix the interest rate from a variable interest rate.

6.02 Foreign Currency Exchange Agreements:

In the case of a foreign currency debenture, the City may only issue a foreign currency debenture if it enters into one or more foreign currency exchange agreements for the debenture on or before the date it issues the debenture. (O. Reg. 247/01, s. 9 (a)). This would convert the interest and principal payable in foreign currency to a Canadian currency amount.

<u>Credit Rating Requirement:</u>

Further to the 6.01 and 6.02 above, the City may only enter a foreign exchange agreement or an interest rate exchange agreement with a counterparty whose debt obligations are rated:

- by Dominion Bond Rating Service Limited as “AA(Low)” or higher,
- by Fitch Ratings as “AA-“ or higher,
- by Moody’s Investors Service, Inc. as “Aa3” or higher, or
- by Standard and Poor’s as “AA-’” or higher.

O. Reg. 276/02, s.11, O. Reg. 247/01, s. 10.

6.03 Bond Forward Agreements:

If the City has passed a by-law authorizing a debenture issue denominated in Canadian currency, it may enter a bond forward agreement in order to minimize the risk related to the debentures because of fluctuations in interest rates (O. Reg. 653/05, s. 2(1)) and thereby set a ceiling on the coupon rate of a planned debenture issue.

The City may enter bond forward agreement for a debenture issue denominated in Canadian currency only if it has passed a by-law authorizing that debenture issue. Bond forward agreements will have a settlement date which is not longer than 180 days or more after which the agreement is executed. O. Reg. 653/05, s. 2(5).

Before the City passes a by-law authorizing a bond forward agreement, Council shall adopt a statement of policies and goals relating to the use of bond forward agreements. Included in the statement of policies and goals are:

- The fixed costs and estimated costs to the City resulting from the use of bond forward agreements;
- A detailed estimate of the expected results of using bond forward agreements;
- Risk control measures relating to such agreements such as credit exposure limits based on credit ratings and on the degree of regulatory oversight and the regulatory capital of the counterparty and ongoing monitoring with respect to the bond forward agreements;
- A comparison of financial and other risks to the City that would exist with and without the use of bond forward agreements.

O. Reg. 653/05, s. 3

<u>Credit Rating Requirements for Bond Forward Agreements:</u>
The City shall only enter into a bond forward agreement with a bank listed in Schedule I, II or III to the *Bank Act* (Canada) and only if the bank’s long-term debt obligations are rated by:

- Dominion Bond Rating Service as “A(high)” or higher; or
- Fitch Ratings as “A+” or higher; or
- Moody’s Investors Service Inc. as “A1” or higher; or
- Standard and Poor’s as “A+” or higher.

O. Reg. 653/05, s. 2(7).

References

- Ontario Regulation 403/02 (Debt and Financial Obligation Limits)
- Ontario Regulation 438/97 (Eligible Investments and Related Financial Agreements)
- Ontario Regulation 247/01 (Variable Interest Rate Debentures and Foreign Currency Borrowing)
- Ontario Regulation 276/02 (Bank Loans)
- Ontario Regulation 586/06 (Local Improvement Charges – Priority Lien Status)
- Ontario Regulation 653/05 (Debt Related Financial Instruments and Financial Agreements);
- Ontario Regulation 603/06 (Municipal and School Capital Facilities – Agreements and Tax Exemptions)
- Ontario Regulation 278/02 (Construction Financing)
- Tile Drainage Act, R.S.O. 1990, c. T.8 and regulations thereunder.
- City of Hamilton Reserve/Revenue and Trust Accounts Statement of Investment Policies and Procedures
- City of Hamilton Reserve Policies
- City of Hamilton Lease Financing Policy
- City of Hamilton Code of Conduct for Employees Policy
- GFOA *Best Practice* Debt Management Policy (1995, 2003 and 2012) (DEBT)
- GFOA BEST PRACTICE APPLICABLE IN CANADA Debt Management Policy (2003)

LEASE FINANCING POLICY

CITY OF HAMILTON

The City of Hamilton
Lease Financing Policy

Policy Statement

This policy constitutes the City of Hamilton's statement of policies and goals relating to the use of lease financing agreements as required under Ontario Regulation 653/05 made under the *Municipal Act*, *2001*.

Purpose

The purpose of this policy is to provide guidance to staff when contemplating lease agreements for the provision of municipal equipment and facilities. Lease Financing Agreements may be preferred to outright purchase and/or debt financing of equipment and facilities. The City may enter into lease arrangements in order to acquire the rights to use capital property and equipment, including some or all of the benefits and risks of ownership for specific periods of time and stipulated rental payments.

Definitions

Combined Material Impacts -	The costs or risks of a proposed Non-Material Lease which, when combined with all other Non-Material Leases entered into or proposed to be entered into in a particular year by the municipality would result in an amount of payment exceeding 20% of the annual debt and financial obligation limit for the City as determined in accordance with Ontario Regulation 403/02.
Lease Financing Agreement -	A financial arrangement, including a Material Lease or a Non-Material Lease, whereby equipment or municipal capital facilities are provided to the City by a third party in exchange for a series of payments that may extend beyond the term for which Council was elected (includes renewal options).
Lease Term -	The term of the lease shall be the entire term of the lease including any possible extensions or renewals as stated in the lease.
Material Impact -	A Lease Financing Agreement has a material impact on the City if the costs or risks associated with the agreement significantly affect the City’s debt and financial limit determined in accordance with Ontario

Regulation 403/02, or would reasonably be expected to have a significant effect on that limit.

Material Lease - A Lease Financing Agreement which extends beyond the term of Council which requires annual payments of $150,000 or more or a lease term of more than five years for commercial real property.

Non-Material Lease - A Lease Financing Agreement which requires annual payments of less than $150,000 annually with a lease term of less than 5 years.

Classes of Capital Municipal Facilities:

Lease Financing Agreements may be entered into for the provision of the following classes of municipal capital facilities:

1. facilities used by Council
2. facilities used for the general administration of the municipality
3. municipal roads, highways and bridges
4. municipal local improvements and public utilities
   municipal facilities for the generation of electricity
5. municipal facilities related to the provision of telecommunications, transit and transportation systems
6. municipal facilities for water, sewers, sewage, drainage and flood control
7. municipal facilities for the collection and management of waste and garbage
8. municipal facilities related to policing, fire-fighting and by-law enforcement
9. municipal facilities for the protection, regulation and control of animals
10. municipal facilities related to the provision of social and health services, including long-term care homes under Part VIII of the *Long-Term Care Homes Act, 2007*
11. municipal facilities for public libraries
12. municipal facilities that combine the facilities described in paragraphs 1 to 11
13. parking facilities ancillary to facilities described in any of the paragraphs 1 to 12
14. municipal community centres
15 parking facilities ancillary to facilities described in paragraph 14
16. municipal facilities used for cultural, recreational or tourist purpose
17. municipal general parking facilities and parking facilities ancillary to facilities described in paragraph 16
18. municipal housing project facilities

Required Contents

Every Lease Financing Agreement must include a schedule of all fixed amounts of payment, if any, required under the lease and that may be required under any possible extensions or renewals of the lease.

All Lease Financing Agreements (material, non-material, and exempt) are to be reviewed by the Treasurer of the City of Hamilton (“City Treasurer”) for classification, compliance with this policy and calculation of total annual lease payment obligations. Final execution of lease documents requires the signatures of the Mayor, City Clerk and the City Treasurer.

Non-Material Leases

In the opinion of the City Treasurer and City Council, the following types of Lease Financing Agreements will not result in a Material Impact for the municipality and are therefore Non-Material Leases:

- any lease requiring annual payments of less than $150,000.00
- any lease requiring annual payments of less $150,000.00 entered into in accordance with the City's “Purchasing Policies and Procedures” as approved by City Council, including, but not limited to, leases of: office equipment; automobiles; information technology infrastructure; hardware and software; communications equipment; machinery and equipment
- any building or property lease entered into with a term of less than five years
- any leases in place at the time of Council approval of this policy.

Even if a Non-Material Lease does not have to be reported to Council under this policy, the lease shall be reported to Council when required by the City's “Purchasing Policies and Procedures” as approved by Council, or equivalent policy then in effect, or by any other applicable by-law or approved policy and procedure.

If, at any time after a report is made, but before the Lease Financing Agreement is entered into, the City Treasurer becomes of the opinion that a changed circumstance with respect to the proposed lease may result in a Material Impact or a Combined Material Impact for the municipality, the report respecting the proposed lease must be updated as soon as is reasonably possible and presented to Council.

Council Report on Non-Material Leases With a Combined Material Impact

Where a proposed Non-Material Lease in combination with all other Non-Material Leases entered into or proposed to be entered into in a particular year by the municipality would have a Combined Material Impact as defined (section below), the proposed Non-Material Lease is to be reported and reviewed by City Council as if it were a Material Lease under this policy.

Meaning Of Combined Material Impact

In the opinion of the City Treasurer and City Council, a proposed Non-Material Lease in combination with all other Non-Material Leases entered into or proposed to be entered into in any particular year would have a Combined Material Impact ONLY if the annual payment of all such Non-Material Leases were greater than 20% of the City's annual debt and financial obligation limit determined in accordance with Ontario Regulation 403/02. Where such total annual payment is less than 20%, a proposed Non-Material Lease is not required to be reported to and reviewed by Council under this policy.

Process For Approval Of A Material Lease

Treasurer's Report - Before entering into a Material Lease, the City Treasurer shall prepare a report to Council assessing the costs and financial and other risks associated with the proposed Material Lease, including any possible extensions or renewals. The report will include:

- a comparison between the fixed and estimated costs and the risks associated with the proposed Material Lease and those associated with other methods of financing;
- a statement summarizing, as may be applicable, the effective rate or rates of financing for the Material Lease, the ability for lease payment amounts to vary, and the methods or calculations, including possible financing rate changes, that may be used to establish that variance under the lease;
- a statement summarizing any contingent payment obligations under the lease that, in the opinion of the City Treasurer would result in a Material Impact for the municipality, including lease termination provisions, equipment loss, equipment replacement options and guarantees and indemnities;
- a summary of the assumptions applicable to any possible variations in the lease payment and contingent payment obligations; and
- any other matters the City Treasurer or City Council considers advisable.

Council's Role - Council is responsible for determining whether the costs of financing for the proposed Lease Financing Agreement are lower than other methods of financing available to the municipality, and whether the risks associated with the Lease Financing Agreement are reasonable.

In considering the report and recommendation from the City Treasurer, Council is responsible for ensuring that legal and financial advice has been obtained, and must consider whether the scope of the proposed lease warrants further legal or financial advice from an independent source.

If Council decides to approve entry into the Lease Financing Agreement, such approval shall be by by-law.

Annual Report To Council

Once in every fiscal year, the City Treasurer shall provide a report to Council containing the following:

- a description of the estimated proportion of the total financing arrangements of the municipality that is undertaken through Lease Financing Agreements to the total long-term debt of the municipality;
- a description of the change, if any, in that estimated proportion since the previous year's report;
- a statement by the City Treasurer as to whether, in his/her opinion, all Lease Financing Agreements (Material or Non-Material) were made in accordance with this policy;
  any other information that may be requested by Council or that, in the opinion of the City Treasurer, should be recorded.

Policy Review

The Lease Financing Policy will be reviewed periodically by the City Treasurer. Any revisions to the policy must be submitted to Council for consideration and approval. The policy shall be read and interpreted in accordance with the *Municipal Act, 2001*, the *Assessment Act*, R.S.O. 1990, c. A.31, and the regulations thereunder, as amended from time to time, that apply to this policy. The policy will be updated to reflect any change(s) to applicable legislation and regulations at the time of formal review. Otherwise, the City Treasurer must formally review the policy at a minimum of every four years.