



Corporate Report

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DATE: November 18, 2011

TO: Chair and Members of General Committee
Meeting Date: December 7, 2011

FROM: Brenda R Breault, MBA, CMA
Commissioner of Corporate Services and Treasurer

SUBJECT: **City of Mississauga Debt Management Policy**

RECOMMENDATION: That the proposed Debt Management Policy for the City of Mississauga attached as Appendix 1 to the report dated November 18, 2011 from the Commissioner of Corporate Services and Treasurer be approved.

BACKGROUND: The City of Mississauga has operated for many years under a pay as you go philosophy. As the City was being developed, prudent fiscal management policies built significant reserves and infrastructure was emplaced with development related revenues. Now, the City is transitioning to an urban centre, with little green field development and aging infrastructure, and the types of infrastructure demands are beyond the scope, or ineligible, for funding from development related revenues. This necessitates the need to move from a pay-as-you-go philosophy to a policy which incorporates debenture financing as an additional means of funding infrastructure in the City.

As a result, it is necessary for the City to approve a debt policy that provides guidelines for staff to use when the issuance of debentures is the appropriate financing tool for infrastructure.

The *Municipal Act* allows a municipality to issue debentures to build and rehabilitate infrastructure assets that are used to provide

services within a municipality. Under the *Municipal Act*, in a two tier government structure, the upper tier has full responsibility for issuing debenture financing. Despite the fact that Mississauga is the sixth largest City in Canada, since Mississauga is a lower tier municipality, any funding requirements through debenture financing must be issued by the Region of Peel. Other large cities, which are single tier such as London, Hamilton, Ottawa and Toronto, can issue their own debentures. A change in the *Municipal Act* would be required for Mississauga to be able to issue its own debentures.

The City is responsible for approving its capital budget and approving its debenture needs. Once this is done the City notifies the Region of its requirements and requests them to issue debt on the City's behalf. Regional Council must approve the issuance of the City's debt. All debt issued by the Region is a joint and several liability of the Region and its area municipalities. This means that should one municipality default on its debt the Region could levy the other municipalities for the repayment of the debt of the defaulting municipality.

The timing and placement of any debenture issue is the responsibility of the Region. The Region determines the total needs of the area municipalities and Region and approaches the banking syndicate with the total funding the upper tier is looking to raise in the financing market. The Region of Peel then sets out to accumulate the funds required through the financial markets. The administration of the issue and any resulting debt retirement or sinking funds are the responsibility of the Region.

Due to this legislative framework, and the issuance of debt being new to the Region of Peel, Mississauga, Brampton and Caledon, Finance staff from the four municipalities formed a working group to discuss the development of appropriate debt policies. Where possible, the goal was to make policies consistent, while also recognizing that the different types of infrastructure at the upper and lower tiers would necessitate differences in the policies. These differences are noted in the following discussion.

The Region of Peel presented its policy to Regional Council on September 22, 2011. Brampton and Caledon plan to present theirs sometime later.

COMMENTS:

The guiding principles for the City's debt policy, which will help protect the City's AAA credit rating and its long standing financial reputation are:

- A. Adherence to Legislative Requirements
- B. Long-Term Debt Financing for Eligible Capital Works
- C. Long-Term Financial Sustainability and Flexibility
- D. Long-Term Debt Financing Cost Minimization
- E. Long-Term Debt Financing Cost Certainty

A. Adherence to Legislative Requirements

The City's policy is based on the legislative requirements as set out in the *Municipal Act* and its supporting regulations. The *Municipal Act* allows a municipality to issue debentures to build and rehabilitate infrastructure assets that are used to provide services within a municipality. In the past, the City has funded the construction/rehabilitation of tax supported infrastructure only through contributions from current operations (infrastructure levy), reserve funds, and funded growth related infrastructure from development charges.

B. Eligible Capital Works - Projects to Be Debentured

The proposed Mississauga Debt Management Policy defines guidelines for the types of capital projects that the City would consider acceptable for the issuance of debentures. These would include:

- Municipal capital facilities and infrastructure, not funded through Development Charge funding;
- Projects that provide future cost savings or cost avoidance "Cost Mitigation Projects";
- Non-growth share and the 10% mandatory discount portion of Development Charge capital projects.
- Major reconstruction and rehabilitation projects; and
- Development Charge projects required to be emplaced before revenues are received

Funding of new facilities and infrastructure which are not eligible for development charge funding, non growth shares and the 10%

discount on development charge eligible projects from debentures spreads the cost of these assets over the life of the asset and ensures those who will benefit from the asset contribute to its cost.

Funding projects which provide future cost savings or cost avoidance allows these savings to be used to finance the annual debt costs.

Ideally, rehabilitation projects should be funded from funds set aside over the life of the original asset, on a pay as you go basis. Currently the City does not have adequate replacement reserves, and therefore debt funding is required. However, as the infrastructure levy grows, and, if a policy were to be instituted to budget transfers to reserves for future asset replacement when a new capital project is brought into operation, eventually debt should not be required for rehabilitation. This is a major area of difference from the Region of Peel's policy which states that rehabilitation or "Non growth replacement infrastructure" will be funded on a pay as you basis. The Region is able to do this as they have significant replacement reserves, and are annually contributing to reserves more than their asset depreciation or amortization. The City of Mississauga is currently only contributing to reserves about 23% of its annual depreciation. The proposed annual infrastructure levy implemented in 2011 was put in place to gradually increase this funding provision

Regarding Development Charge (DC) projects, the City's policy has been to fund the entire DC portion of the project from the DC reserve fund accounts. If sufficient funding was not available in a specific DC service account this service account could go into a deficit position provided that sufficient balances remained in the other DC service accounts to cover this shortfall. However, as the City moves into slower growth, there may be projects that need to be emplaced before revenue is received, and other service account balances may not be available to offset the shortfall. Debentures could be issued for specific DC projects that would allow the project to proceed while the cost of issuing debt would be recovered through future development charge revenues. There are legislative provisions within the *Development Charges Act* that allow for this to occur. Future DC rates will be established incorporating the use of debenture financing. The Region of Peel

has been utilizing debt financing for Development Charge projects for the last two years, and this is the primary focus of their debt policy and future debt issuance.

C. Long Term Financial Sustainability and Flexibility

Minimum Capital Reserve Balances

The City is known for its financial stability which is in a large part due to its significant reserves, and reserve fund balances. These balances have largely contributed to the City's "AAA" credit rating with Standard and Poor's (S&P), as these provide a strong liquidity position for the City.

Prior forecasts for tax supported capital had been based on the assumption that the City would reduce its Capital Reserve Fund to a minimal cash balance of \$30 million, before issuing debt. For the 2011 forecast, this minimum cash balance was increased to \$60 million. Discussions with S&P, coupled with the City's approaching need for debenture financing, precipitated a review of the City's long term financial strategy. The goal of the review was to find a balance in sustaining the City's liquidity of funds to maintain a "AAA" credit rating without the rating being adversely affected by the issuance of debt.

An "AAA" credit rating indicates a very strong financial position and is very attractive to lenders as it represents a very high quality, low risk credit. This is beneficial as it provides an organization with easier access to debt markets at a lower cost of debt than would be the case for organizations with lower credit ratings.

As noted earlier, S & P has always indicated that a strong liquidity position is an important determinant in the maintenance of a AAA credit rating. Diluting the City's reserves to a minimum balance of \$30 to \$60 million would reduce liquidity, and would not likely be sufficient to preserve the City's current credit rating. Credit agencies prefer to see total reserves and reserve funds equal to or greater than outstanding debt. Given this, it is staff's recommendation that the City retain a minimum balance in the tax funded capital reserve fund equal to the ten-year average annual

tax supported capital forecast. Analysis of tax funded capital needs over the 10 year forecast indicates that the City should have a tax supported capital reserve fund balance of about \$100 million. Retention of this minimum reserve balance will result in the need to issue debt in 2012.

Another driver for retaining the proposed capital reserve fund balance in the \$100 million range relates to the risks associated with raising funds through the financial markets. Municipalities are not as attractive an investment as the Federal or Provincial Government. Even though the City has an “AAA” credit rating, it is possible that the Region may not be able to raise the entire amount required in one debenture issue. It may be necessary for the Region to approach the market more than once to raise all the necessary funds.

To mitigate this risk, the retention of one year’s worth of the ten year average tax supported capital expenditures in the capital reserve funds provides a liquidity safety net, and allows the City to continue with business as usual, in the event there are adverse financing conditions beyond our control.

Annual Debt Repayment Limit

The *Municipal Act* allows for up to 25% of annual municipal net own source revenue to be allocated to debt repayments. Own source revenue includes taxation and user fees but excludes grants from other levels of government transfers from reserves and reserve funds and proceeds from the sale of real property. This limit is for all debt – tax supported debt and debt supported by non-tax revenues. In 2011, the Ministry of Municipal Affairs and Housing (MMAH) determined the City’s annual debt repayment limit to be \$139.9 million (excluding \$2.7 million allocated to future lease payments).

As the City of Mississauga currently has no debt, there are no funds budgeted for debt repayment – any issuance of tax supported debt will require a tax increase to finance debt repayment charges. Allowing debt payments to comprise 25% of our own fund revenues would require a tax increase of considerably more than 25%.

Therefore, a maximum debt limit percentage of the total City net own revenue should be put in place. By instituting a debt limit, it provides a level of confidence to the credit agencies and the banking syndicate that the City can easily meet its future debt repayment requirements.

A quick survey of Southern Ontario municipalities' web sites indicates that the debt limit percentage set by each municipality is much lower than that prescribed the MMAH.

The City of Burlington has a debt ceiling limit of 10% for tax supported debt over a ten year period, and a 2.5% debt limit for non-tax supported debt charges for a combined debt limit of 12.5%.

The Town of Oakville has adopted a policy that ensures that tax supported debt does not exceed 6.25% of revenue fund revenues and total debt including non-tax supported debt does not exceed 12%. Additionally, only 25% of the ten year average DC revenue can be committed to debt repayment.

The City of Ottawa has determined that its debt servicing limits will not exceed 7.5% of funds raised from taxes and fees and the terms of the debt will not exceed the useful life of the asset and the level of total debt issued will not exceed the provincial limit as provided in the *Municipal Act*.

The City of Toronto has set their debt limit at 15%. Halton Region has a 15% target for total debt repayments. The City of London establishes total debenture "caps". In 2011, the City of London Council approved a \$26 million average debt cap.

The Region of Peel is not establishing a limit below 25%. However, as noted earlier, their debt policy assumes that the majority of debt to be issued by the Region will be for development charge projects and will be repaid from DC's. This debt is counted against the annual repayment limit but is not funded from taxes. However, Mississauga's debt will be largely tax supported and therefore a limit below 25% is prudent and as noted earlier, provides a level of confidence to the credit agencies

and the banking syndicate that the City can easily meet its future debt repayment requirements.

Staff is recommending that the City of Mississauga set its debt charge limit not to exceed 10% of own source revenue based on a review of the City's 10 year tax supported debt requirements and keeping in mind its impact on future tax rates. The 10% debt limit has been included as part of the debt policy contained in Appendix 1.

As noted earlier in the report, the City's practice for allowing development charge reserve fund balances to be in a deficit position has resulted in discussions on whether it would be appropriate to issue debentures for DC capital projects. The City's development charge supported infrastructure is different in nature than the Region's. Regional water and sewer services must be emplaced before development can occur whereas the City's services largely can be emplaced after development occurs. Due to the volatility of development charge related revenue it is prudent to have limits on the amount of debt the City would undertake for development charge projects to ensure that annual revenues are sufficient to cover the debt servicing costs. Staff are recommending a development charge debt charge limit that does not exceed 25% of ten-year average annual DC revenues, or 5% of annual municipal own source revenues whichever is triggered first. The total debt limit for tax-supported and non-tax supported debt would then be 15%.

Key Financial Indicators

Standard and Poor's has provided City Finance staff with guidance on financial metrics to measure the financial health of a corporation. A goal of this policy is to maintain Mississauga's superior credit rating, therefore the policy identifies key indicators which will be monitored and presented as part of the City's long term financing plan. These include:

- Debt per Capita
- Debt charges per capita
- Debt charges as a percentage of own source revenue
- Debt charges as a percentage of the municipal levy
- Debt to total reserves and reserve funds

D. Long-Term Debt Financing Cost Minimization &**E. Long-Term Financing Cost Certainty**

The timing, type and term of debt financing for the Approved Capital Budget will be determined in discussions with the Region in order to minimize the City's overall long-term cost of financing. Typically, shorter term interest rates (five year borrowing rates) are lower than longer term interest rates (30 year borrowing rates). In order to minimize interest costs over time, while the debenture financing will ideally be established to match the useful life of the debentured asset, the term of any particular Debenture may be shorter than the useful life of the capital asset. In any case, it will not exceed the lesser of 30 years or the estimated useful life of the underlying asset. It is anticipated that the City's normal practice will be to issue Debentures with the term ranging between five and 15 years, unless interest curves become inverted.

The policy also provides for the use of bridge financing; construction financing; and variable rate interest loans but with a limit of up to only 15% of total debt.

Debt Issuance Process and Administrative Issues

As noted earlier, the structure, timing and placement of any debenture issue is the responsibility of the Region. The City of Mississauga's role is approving its capital budget and its debenture needs, and identifying the term it wishes to issue. Once this is done the City notifies the Region of its requirements and requests them to issue debt on the City's behalf

The City's Corporate Finance Division will determine the annual debenture requirements based on submission of the 10 year capital budget requests by the departments and identify the specific projects to be debentured, for approval by the Treasurer subject to Council's authorization. Projects to be debentured must not have started – debt financing must be approved before any work commences. Upon approval of the Capital Budget, any required by-laws will be passed to authorize the issuance of debentures and the maximum term of the debt financing. Additionally, a Treasurer's certificate attesting that the debenture requested is within the annual debt repayment limit for the City will accompany

the by-law. All by-laws and certificates are submitted to the Region to support the City's request for debenture financing.

The Region has requested that the lower tier municipalities provide them with high level estimates of their debenture needs at least 18 months, in advance of the need (within a range of \$25 million), to be confirmed within six months of issuance (within a range of \$5 million).

The administration of the debt issue and any resulting sinking funds is the responsibility of the Region. The City's responsibilities will be to transfer the annual debt payments or sinking fund contributions to the Region, and the cash management of all debenture proceeds. The annual repayments will be budgeted in non-departmental budgets, rather than into service budgets, as the service area should not have to rationalize a financing decision. The only exception to this would be where the project being debenture financed generated significant cost savings to offset the debt payments.

FINANCIAL IMPACT:

The 2011-2020 tax supported Capital Budget & Forecast requests are \$998.8 million (inflated, cash flowed). The potential debenture financing requirements to support this program are \$446.1 million, and it was forecast that the City would begin to issue debt in 2013. The 2012 to 2021 Capital Forecast is currently being prepared. The Capital Reserve Funds balance at the end of December 31st, 2010 was \$132.1 million. Therefore, to maintain the liquidity levels as recommended by S&P, the City would be in a position to require the issuance of debt in 2012 based on the remaining cash balance of the capital reserve fund.

In accordance with the provisions of the *Municipal Act* Mississauga's 2011 annual debt repayment ceiling is \$139.9 million based on an interest rate of 7% over a period of 10 years which allows for borrowing of \$980.4 million over the same time period. The City forecast of debt requirements in the 2011-2020 Capital forecast is \$446.1 million over the next ten years. The annual debt repayment charges to service this debt will be in the range of \$50 million once fully issued and have an average annual impact of 1% on property taxes over the next 10 years. This is over and above the current 1% infrastructure levy.

CONCLUSION:

The City of Mississauga has reached the point where the issuance of debentures will become a necessary financing method for tax supported expenditures in the future. In anticipation of this requirement, the City must put a policy in place that will provide guidance for staff while safeguarding the City's long standing reputation for prudent financial management.

ATTACHMENTS:

Appendix 1: Draft Debt Policy



Brenda R. Breault, MBA, CMA
Commissioner of Corporate Services and Treasurer

Prepared by: Patti Elliott-Spencer; Director of Finance

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TAB: FINANCE
SECTION: INVESTMENTS
SUBJECT: DEBT MANAGEMENT

POLICY STATEMENT

The City of Mississauga strives for the optimum utilization of all available financial resources within statutory limitations. The City recognizes the basic need to protect and preserve capital, while maintaining solvency and liquidity to meet on-going financial requirements. The City understands that the prudent issuance of Debt is an efficient use of available financial resources.

PURPOSE

The purpose of this policy is to outline the methods the City will use to manage its Debt in accordance with the City's Guiding Principles.

SCOPE

This policy applies to all future Debt of the City of Mississauga.

Investment management of Debt issuance proceeds are restricted by the City's Corporate Policy and Procedure - Finance - Investments.

DEFINITIONS

For the purposes of this policy:

“Annual Debt Financing Charges” means the 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.

“Approved Annual Budget” means the annual operating budget

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adopted by Council, and which is the basis for any tax-rate change in a single fiscal year.

“Approved Capital Budget” means the budget estimate for capital project(s) and/or capital program(s) that has been adopted by Council, and is the level at which Council approves funding and fund controls.

“Bank Loan” means 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.

“Banker’s Acceptance” means 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.

“Capital Reserve Fund” means the monies set aside for the repair and major maintenance costs of capital infrastructure and for large approved capital expenditures, such as the renovation of a community centre or road reconstruction.

“Commissioner” means the Commissioner of Corporate Services and Treasurer or designate, in writing.

“Construction Financing” means a form of Debenture financing for revenue generating capital projects whereby the issuer does not pay any principal and/or interest for periods of normally up to five years during the construction period.

“Cost Mitigation Project” means any capital project whereby the

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baseline costs in the Operating Forecast are reduced as a result of the proposed capital project, either through forecast revenue increases or forecast expenditure decreases.

“Debenture” means a formal written obligation to repay specific sums on certain dates. Debentures issued by a municipality are unsecured and are backed by the good faith and credit of the municipality.

“Debenture” means a formal written obligation to repay specific sums on certain dates. Debentures issued by a municipality are unsecured and are backed by the good faith and credit of the municipality. Municipalities are authorized to issue Debentures for long-term borrowing of capital projects. Authorized types of Debentures include: Sinking Funds; instalment (serial); term; amortizing; Retirement Funds; Construction Financing and Variable Interest Rate.

“Debt” means any obligation for the payment of money. For Ontario municipalities, Long-Term Debt normally consists of Debentures; Short-Term Debt normally consists of notes or 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 as Debt.

“Debt and Financial Obligation Limit” means Ontario Regulation 403/02 (Debt and Financial Obligation Limits), which is the limit or amount provided annually to a municipality by the Ministry of Municipal Affairs and Housing (MMAH) that constitutes the maximum amount of new annual debt serving costs that a municipality can undertake, or guarantee, without seeking the prior approval of the Ontario Municipal Board (OMB). The

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Commissioner is to calculate and report annually to MMAH the Annual (Debt) Repayment Limit (ARL), as required by the legislation and related regulations. Additionally, the Commissioner shall recalculate an updated limit using the most recent ARL and provide this to Council before Council authorizes specific work or class of work or any increase in expenditure for a previously authorized specific work or class of work that requires Long-Term Debt issuance.

“Development Charges” means those charges imposed under the City of Mississauga Development Charges By-Law 342-09, as amended.

“Director” means the Director, Finance, Corporate Services Department, or designate, in writing.

“Infrastructure Ontario” means the 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.

“Lease Finance Agreement” means a lease allowing for the provision of Municipal Capital Facilities, if the lease may, or will, require payment by the Corporation beyond the current term of Council.

“Long-Term Bank Loan” means Long-Term Debt provided by a bank or a syndicate (group) of banks.

“Long-Term Debt” means any Debt for which the repayment of any portion of the principal is due beyond one year.

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“Municipal Capital Facilities” includes land, as defined in the *Assessment Act*, works, equipment, machinery and related systems and infrastructures.

“Operating Forecast” means the projection of expenditures, revenues and staffing levels beyond the Approved Annual Budget year in which the forecast is made.

“Own-Source Revenue” means revenue for a fiscal year, excluding:

- a) grants from the Government of Ontario or Canada or from another municipality
- b) proceeds from the sale of real property
- c) contributions or net transfers from a Reserve Fund or reserve
- d) 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,
- e) other municipality or school board receipts for the purpose of repayment of the principal and interest on Long-Term Debt of the municipality borrowed for the exclusive purpose of the other municipality or school board

“Reserve Fund(s)” means a fund that is segregated and restricted to meet a specific purpose. Monies set aside for a Reserve Fund(s) must be deposited into a separate bank account and the interest earned on those investments must be added to the Reserve Fund(s).

“Short-Term” means any Debt obligation for which the repayment of the entire principal is due within one year.

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“Sinking Fund” means a segregated pool of funds managed by the Region of Peel for which an estimated amount in each year, with interest compounded annually, will be sufficient to pay the principal of the related Sinking Fund Debentures at maturity.

“Retirement Fund” means a segregated pool of funds managed by the Region of Peel for a class of Debentures other than a sinking fund or term Debenture. In each year the fund must contain an amount equal to or greater than the amount required for the repayment of the principal of specific Debentures in that year if the principal had been payable in equal annual instalments and the Debentures had been issued for the maximum period authorized by the municipality for the repayment of the Debt for which the Debentures were issued.

“Variable Interest Rate Debentures” means Debentures that provide for one or more variations in the rate of interest payable on the principal during the term of the Debentures.

GUIDING PRINCIPLES

The following are the City’s Guiding Principles for the management of its Debt obligations, which will help protect the City’s AAA credit rating and its long-standing financial reputation:

- Adherence to Legislative Requirements
- Long-Term Debt Financing for Eligible Capital Works
- Long-Term Financial Sustainability and Flexibility
- Long-Term Debt Financing Cost Minimization
- Long-Term Debt Financing Cost Certainty

ADHERENCE TO LEGISLATIVE REQUIREMENTS

Debt issuance at the City will only be undertaken in compliance with the provisions of the *Municipal Act, 2001* (the Act),

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specifically Part XIII - Debt and Investment, as well as 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); and 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 for 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. By-law 0052-2003 governs the authorities and controls for the use of temporary borrowing.

Regional Debt Administration

Under Section 401 of the Act the Region of Peel issues Debentures for the City. This includes arranging Debenture financing; collection of interest and principal; and Act compliance and administration of Sinking Funds and Retirement Funds.

Under Section 401 (3.1) of the Act, Debentures constitute direct, joint and several obligations of the Region of Peel and its lower-tier Municipalities.

Authority to Manage Debt Proceeds

City of Mississauga By-Law 0323-2000, as amended, delegates authority for the development and management of cash, securities and Debt to the Commissioner and the Director. The By-Law details the specific authorization required for each action outlined in the By-Law.

LONG-TERM DEBT FINANCING FOR ELIGIBLE CAPITAL WORKS

The following capital works items are eligible for Long-Term

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Debt financing:

- 1) New Municipal Capital Facilities and Infrastructure not funded through Development Charges
- 2) Cost Mitigation Project
- 3) Storm Water Management
- 4) Non-growth share and the 10% mandatory discount portion of Development Charges capital project
- 5) Major Reconstruction and Rehabilitation
- 6) Development Charges projects required to be emplaced before revenues received.

LONG-TERM FINANCIAL SUSTAINABILITY AND FLEXIBILITY

The City' credit rating agency, Standard & Poor's (S&P), provides City Finance staff with guidance on financial metrics to measure the financial health of a corporation. Some key indicators which will influence the Approved Capital Budget, and which the City will monitor to ensure long-term financial sustainability, include:

- Debt per capita
- Debt charges per capita
- Debt charges, as a percentage of Own-Source Revenue
- Debt charges, as a percentage of the municipal levy
- Debt to operating revenues
- Debt to Reserves and Reserve Funds
- Cash and liquid assets to operating expenditures

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

- 1) Total Debt Limit is set at 15% of City Own-Source Revenues, comprised of:

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- a) Annual Debt Financing Charges (excluding Debt financing for Development Charges debentured projects, and any Debt financing for projects supported by non-tax revenues), inclusive of any budgeted or proposed Debt issue, and which are comprised of the principal and interest component (or of the interest and Sinking or Retirement Fund contribution component) for the related Debenture, will not exceed 10% of tax-supported Debt as a share of City Own-Source Revenues, unless otherwise approved by Council.
 - b) Annual Debt Financing Charges for non-tax supported Debentures, i.e. Debentures that are funded by Development Charges revenues, or other non-tax revenues, will not exceed 5% of City Own-Source Revenues.
 - c) The Development Charges funded Debt limit will be further subject to a limit equal to 25% of the 10 year forecast of average annual Development Charges revenues.
- 2) To ensure financial solvency, liquidity and flexibility, the City will maintain a minimum threshold balance in the Capital Reserve Fund, which is equivalent to one year's worth of the 10 year average of the tax-supported capital expenditure requirements.

Capital Reserve Fund balances to be used for Approved Capital Budget funding calculation purposes will be the closing balances of Reserve Funds from the 3rd quarter of a given year.

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- 3) 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.

LONG-TERM DEBT FINANCING COST MINIMIZATION

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. Typically, shorter term interest rates (five year borrowing rates) are lower than longer term interest rates (30 year borrowing rates).

In order to minimize interest costs over time:

- 1) While the amortization of Debenture financing will essentially match the useful life of the Debentured asset, the term of any particular Debenture may be shorter than the useful life of the capital asset and, in any case, will not exceed the lesser of 30 years or the estimated useful life of the underlying asset.
- 2) In no case will the term of financing exceed the anticipated useful life of the underlying asset or the maximum term of 40 years, in accordance with the Act.
- 3) Banker's Acceptance, which may be issued to bridge finance pending issuance of a Debenture, will reduce up-front interest costs on an ongoing basis.
- 4) In accordance with Ontario Regulation 247\01, the City may issue Variable Interest Rate Debentures, wherein the interest

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rate is typically lower than a fixed rate Debenture.

- 5) 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 determined by City Finance staff, designated in writing.
- 6) Construction Financing methods will be considered in accordance with Section 405 of the Act. In advance of the issuance of Debentures, Short-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) The City (with a AAA Credit Rating) would normally realize its lowest financing cost under its name, or the Region's. However, there may be times when the City may receive a subsidized financing rate which is lower, due to its participation in a multi-party large scale capital project. In this circumstance, Lease Finance Agreements may be considered if and when it is financially beneficial to the City to enter into this form of borrowing.
- 8) Cost reduction factors which influence the timing and type of Debt to be considered by City Finance staff, designated in writing, include:
 - a) timing of costs and revenues related to a project and any offsetting cost savings attributable to a project,
 - b) the optimal usage of overall City cash,

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- c) Capital Reserve Fund levels, over minimum balances, and the availability of surplus Reserve Fund monies.

LONG-TERM DEBT FINANCING COST CERTAINTY

Debt financing will be managed in a manner to limit, where practicable, variations in costs. As a result, it will be the City's normal practice to require that the Region of Peel issue Debentures with a fixed interest rate over the issuance term (which eliminates increases in interest cost for the respective Debentures issue) and that is only denominated in Canadian dollars (which eliminates exchange rate risk).

Where variable rate Debt exists in conjunction with any other outstanding Variable Interest Rate Debentures or loans, the total outstanding variable interest rate Debt of the City will not exceed 15% of all outstanding Debt.

Through the Region of Peel, bond forward agreements may be entered. A bond forward agreement, which is similar to purchasing a forward diesel fuel contract, can lock-in a forward interest rate, with an 'insurance premium', for up to six months in advance. While this instrument provides cost certainty, the price to lock-in a future interest rate may not be cost effective. The City will reserve the right to not participate in any bond forward agreement that the Region enters.

NOTICE PERIOD

The City recognises that, in order to ensure orderly placement of a Debenture issue within capital markets, the Region of Peel requires a long notice period (18 months, with a \$25 million variance; six months, with a \$10 million variance) for the issuance of Debentures.

City Finance staff, designated in writing, will provide no less than 75 days of official notice, in writing, to the Region of Peel

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regarding City participation in the issuance of Debentures.

REFERENCE:

LAST REVIEW DATE:

CONTACT:

For more information, contact the Investment Portfolio Manager,
Finance Division, Corporate Services Department.

DRAFT