HALIFAX
REGIONAL MUNICIPALITY

PO Box 1749
Halifax, Nova Scotia
B3J 3A5 Canada

Item No. 3

Halifax Regional Council
June 24, 2008
Committee of the Whole

TO: Mayor Kelly and Members of Halifax Regional Council

SUBMITTED BY:

Dan English, Chief Administrative Officer

Geri Kaiser, Deputy Chief Administrative Officer - Corporate Services and Strategy

DATE: June 17, 2008

SUBJECT: **HRM Debt Policy Proposed Revision**

ORIGIN

- Council approved Multi-Year Financial Strategy and related Debt Policy, 1998 &1999
- Staff commitment during 2008/09 Budget debate to return to Council with revised HRM Debt Policy in response to questions and issues raised during debate.

RECOMMENDATION

It is recommended that Regional Council:

- Approve the revisions to the HRM Debt Policy and Debt Servicing Plan as part of the existing Multi-Year Financial Strategy, and as outlined in the discussion section of the report.

EXECUTIVE SUMMARY

The existing Capital Debt Policy has provided a strong tool to reduce debt by over $80 million since 1998 and create stability and predictability in the annual capital budget process. Infrastructure deficits are creating concern for staff and Council. Staff have been asked by Council to examine the existing debt policy to determine whether any changes are warranted at this time to ensure HRM's overall financial well being is appropriately supported.

Staff conclude that due to the stewardship shown by this and previous Council's since 1998, HRM is at more than a mid-way point between the financial instability that existed in 1998 and the financial capacity and flexibility required to achieve the infrastructure and other goals articulated in the Regional Plan and other strategic initiative documents approved and endorsed by Council. As such staff are recommending only minor changes to the existing Capital Debt Policy in order to allow the continued benefits of the Policy to be realized. The recommended changes are outlined in the tables in the Discussion section of the report.

BACKGROUND

In June of 1999 Council approved a number of recommendations related to the *"Taking Care of Business: A Multi-Year Financial Strategy"* report. These recommendations included:

- Pay interest on all reserves starting in 2000/01.
- Include Multi-Year Impacts in all reports to Council.
- Initiate Business Plans and include Operating, Capital and Reserve budget requirements starting in 2000/01.
- Adopt the Debt Servicing Plan.
- Phase in the transfer of funding from debt to operating, short term and recurring capital expenditures evenly over five years.
- Approve the inception of a Service Improvement Reserve to provide loans for HRM business redesign projects that require seed capital.

These recommendations have all been implemented and with the commitment of staff and Council, they have completely changed both the financial direction and overall financial health of the municipality.

In addition to the recommendations above, the MYFS includes a number of policies which were approved by Council while the plan was being developed including: Principles of Financial Management; Reserves Policy; Capital Spending Policy; Capital Debt Policy; and a Business Planning Process.

The current Capital Debt Policy was approved by Council May 18, 1999. In the preface to the policy it is stated that the "Capital Debt Policy is intended to provide a framework for reducing the debt of HRM in the long term financial context of the Municipality". Three strategies were approved to achieve the Policy. They included: 1) a plan to reduce capital debt by restricting capital funding by debt to an amount less than the amount of debt being retired; 2) five year upper and lower limits for debt servicing; and 3) development of a five year Debt Servicing Plan.

The existing Capital Debt Policy is included as Appendix A. Perhaps the best known element of the Capital Debt Policy restricts new general rated debt issued to a percentage of the amount of debt retired in the same year. The Debt Servicing Plan sets this target for debt reduction at 20% of the debt retired in the same year.

The results of the Capital Debt Policy and the MYFS have been significant. The Debt Servicing Plan articulates the original expected results, specifically a planned reduction in debt in the first 5 years of the Policy of $45.7 million. This target was exceeded by $4.6 million with a total reduction in debt in the first 5 years of the Policy of $50.3 million. To the end of fiscal 2007/08, total net debt funded by the general rate was $265 million for a total reduction of $82.5 million.

Over the years exceptions to the existing policy have been brought to Council when the circumstances were so compelling that staff felt the recommended course of action better achieved the objectives of the MYFS. Two of those situations were: 1) Metro Park - Net operating surpluses from the facility management were available to repay the capital purchase; 2) Alderney Gate - operating savings from the elimination of costly lease payments far exceeded debt payments associated with the purchase of the building.

In the 2008/09 budget process, staff requested Council's authority to examine the impact of population and dwelling unit growth on the debt policy. Council agreed that staff investigate the possible impact on existing debt targets if adjustments were made to the debt target based on actual growth experienced in HRM in the past 9 years compared to growth assumptions at the time the Debt Policy was approved. In addition, Council asked staff to examine the implications of using new revenue sources such as Gas Tax, GST rebates and general expenditure savings to service additional debt beyond that which is permitted by the Debt Policy. Both the request from staff and from Council to examine various means of expanding the capital budget were related to concerns associated with HRM's growing infrastructure deficit and the possible cost implications of continued deferred recapitalization of existing assets. The results of this work were incorporated into the 2008/09 budget process, debated by Council and included in the 2008/09 budget on a one-time basis.

DISCUSSION

Goals of the Existing MYFS & Debt Policy

The goals of the existing Capital Debt Policy were and are to reduce overall capital debt, provide predictability around debt available for the capital budget each year and to provide improved structure around the capital budget and related assumptions.

The MYFS was developed at a time of both financial and structural instability. HRM faced a significant loss in commercial assessment, cost implications resulting from the Provincial/Municipal Service Exchange, amalgamation transition costs and the new solid waste system. This was a near crisis situation - capital debt was spiraling, operating costs were growing fast, tax revenues were diminished. As a new organization there was no approved business planning or budgeting framework nor were there any financial management policies to guide staff and support Council in their decision making.

The MYFS and Capital Debt Policy has delivered what it was designed to do, specifically to create stability where there was instability. To quote the Principles of Financial Management approved by Council December 1, 1998, HRM's financial objectives were:

- to maximize its financial flexibility (the degree to which HRM can increase its financial resources to respond to rising commitments)
- to minimize its financial vulnerability (the degree to which HRM can increase its financial resources to respond to rising commitments)
- to ensure long term program sustainability while safeguarding the interests of its taxpayers (the degree to which HRM can maintain existing programs without increasing the debt burden)

The outcomes contained in the MYFS are not service or program outcomes they are capability outcomes.

What has changed since 1998?

- the debt trend has reversed from rapid increase to steady decline
- commercial assessment recovered from its decline and has consistently grown
- 80% of the annual capital budget is funded from operating revenues and only 20% from debt - this is a nearly total reversal from 1998
- cost pressures are increasing to support existing aging infrastructure
- Regional Plan has been approved which sets out a 25 year vision of planned growth and identifies where we need to grow and what capital infrastructure is required to meet the objectives of the Regional Plan
- public expectations have changed, evolving and growing as we meet each expectation along the way

The MYFS and Capital Debt Policy has allowed HRM to move along a path toward improved financial flexibility so that when the community and Council set a specific path for the future, articulating specific outcomes, the financial capacity will be there to achieve it. HRM is well along the road to creating both the clear picture of the future and the financial capacity to achieve it but there remains significant work to be done in both areas. Now is the time to stay the course.

HRM debt per capita remains high relative to similar sized municipalities. The credit rating for

HRM has improved from A/Stable to A/Positive, but still lags behind other comparable communities in its overall financial capacity. Halifax's peer group includes:

Belleville	(A+/Stable/—)	Italian city of Genoa	(A/Stable/—)
Kingston	(A+/Stable/—)	Swiss city of Lausanne	(A+/Stable/—)
Laval	(A+/Positive/—)	Spanish city of Malaga	(A/Stable/—)
Thunder Bay	(A+/Stable/—)	New Zealand city of Waitakere	(A+/Stable/A-1)
Czech city of Brno	(A-/Stable/A-2)		

HRM has not traditionally enjoyed the same level of financial support from the Federal or Provincial governments as other comparable municipalities in Canada. While new programs such as the Gas Tax and Building Canada Fund have brought significant contributions to the current and future capital programs, the historical deficit in this area requires that HRM be more able to carry its own financial weight than its peers. In 2006 the Regional Plan outlined the top 6 areas where the Plan could improve HRM's long term financial position. These risks included: Unplanned growth; Infrastructure capacity gap; Fair and equitable relationships (Fed/Prov); HRM's competitiveness; Residential taxation; Community expectations.

Existing goals & Capital Debt Policy Revisions

Almost 10 years after the MYFS and related Debt Policy was approved there is little question that these remain important goals for any HRM debt policy. HRM's existing net debt, whether on a per dwelling unit, per capita basis or using debt service costs as a % of total operating expenditures remain higher than we might wish to achieve the MYFS objective of financial flexibility. The infrastructure deficit that exists nationally is a significant reality in HRM. Limited resources and investment from other levels of government over time and other conflicting priorities have resulted in existing assets that are not adequately or consistently recapitalized. The result is a poor asset condition overall and a declining asset condition trend for some asset classes. In addition, some communities in HRM have experienced significant growth in recent years, driving higher use on existing assets and an increasing demand for new assets.

On the basis of our current financial and infrastructure position, staff believe this is a time to remain focused on achieving the existing goals to improve financial flexibility, sustainability and reduce our overall financial vulnerability. Much progress has been made and both Council and the community should be very proud of its stewardship during this period. Therefore, the existing debt policy provides the guidance necessary to support HRM through this "Getting Ready" stage and only a few revisions are required to create the environment needed to achieve continued improvement in our financial results while being able to respond to significant opportunities when they present themselves.

Table 1 - recommended revisions to HRM Capital Debt Policy

Capital Debt Policy Sections - Existing	**Change / No Change**	**Comments / Revision**
1. Debt can only be issued in compliance with all appropriate provisions in the MGA and with the CAO & Council's approval	No change	None required
2. The Director of Finance will be responsible for administering capital debt & this policy.	No change	None required
3. A capital Debt Servicing Plan with five year debt projection will form an integral part of the annual budget and will include and upper and lower limit.	Change	Remove lower limit
4. The CAO will provide Council with a report annually as the total capital debt issued and approved.	No change	None required
5. Debt funding will be restricted to items with a life expectancy of at least 10 years.	Change	As the Tangible Capital Asset Project moves forward, new definitions will be approved for Capital assets. Until that time no change.
6. Debt for a specific capital project will be issued for a period no longer than the expected useful life of the asset.	Change	Eliminate - not required, debt will not be issued by MFC for a term greater than the useful life of the asset.

7. The dollar amount of new issued debt funded from the general tax rate will be limited to the debt being retired in the same year, less a reserve for debt retirement.	Change	Minor wording changes to remove confusion should be made. Item 7 of the policy should replace the term "reserve for debt retirement" with the term"target for debt reduction" to more accurately reflect what actually occurs. The target amount is set in the debt service plan.
8. Capital Debt will be segregated in the Accounting records.	No change	None required
9. The capital debt policy will be reviewed annually with the budget.	No change	None required

The mechanism through which the Debt Policy is managed is the Debt Servicing Plan. Therefore, the Debt Servicing Plan sections are outlined below along with the specific changes to support the revisions to the Policy.

Table 2 - Recommended revisions to Debt Serving Plan

Debt Servicing Plan Sections - Existing	**Change / No Change**	**Comments / Revision**
1. Current net debt funded from the general tax rate will reduce every year.	No change	None required
2. New issued debt to be funded from the general tax rate will be limited to the debt being retired less a reserve for debt retirement.	Change	Minor wording changes to remove confusion should be made. Item 7 of the policy should replace the term "reserve for debt retirement" with the term"target for debt reduction" to more accurately reflect what actually occurs.
3. The upper limit for debt funded from the general tax rate will be the net debt position at the end of the previous year.	No change	None required

4. The lower limit for net debt funded from the general tax rate to March 31, 2004 will be $300 million	Change	Remove lower limit. Net debt funded from the general tax rate was lower than this limit as at March 31, 2004 and continues to decline. No need for a lower limit now.
5. The reserve for debt retirement will be 20% of the debt retired in the same year.	Change	Reduce the 20% target to 15% and restrict the increased debt capacity to those projects which strictly meet the criteria of the Service Improvement Reserve Any unused debt authority related to this revision will be pooled for potential use in future years or can be allocated as additional debt reduction.
6. 100% of the Capital budget funded by debt will be debentured.	No change	None required

Other revenue sources including Gas Tax and GST to support additional debt
The Debt policy limits "general tax rate supported debt". Therefore Harbour Solutions debt is excluded as it is funded through the pollution control charge, as is debt funded by Local Improvement Charges or area rates.

Under the existing Gas tax agreement it appears that these revenues would be permitted to service debt as long as that debt is solely related to projects that meet the criteria of the agreement. Therefore from a Gas tax agreement perspective this is an option but would require specific investigation on a project basis to ensure that funds were not jeopardized.

In assessing these revenues against the debt policy, it must be determined whether any debt that these revenues fund is within the definition of "general tax rate supported debt". These revenues are typically received by HRM to finance those projects that would otherwise be funded by general tax rates. Therefore, any debt funded by these revenues would fall under the definition of "general tax rate supported debt". However, the more relevant issue here is whether or not allowing these funds to be used to support new debt is consistent with the goals the debt policy is designed to achieve. It has been noted that situations have occurred in the past where the approval of more debt than the Capital Debt Policy would allow was in the better interest of improving HRM's overall financial well being.

In evaluating whether these funds should be used to service additional debt, the primary assessment criteria should be whether or not this would be in the best interest of HRM's overall financial well being. In the past Council has determined that taking on additional debt was warranted when the new project generated it's own revenue sufficient to cover the debt payments (Metro Park) or when the cost savings were not only sufficient to cover the debt repayments and related interest but also provided significant additional savings (Alderney Gate purchase). In 2008/09 staff indicated to Council that maintenance costs related to deferred capital projects were sufficiently high and the focus on existing capital projects had displaced so much new capital that taking on extra debt was warranted on a one-time basis. Therefore, any decision on whether more debt should be approved than is permitted under the debt policy should be based on the following:

General Criteria for Exclusion from Debt Servicing Plan

1) Is it in the best interest of HRM's long-term financial health to borrow funds to advance projects faster than would otherwise be possible under the Capital Debt Policy?

a) Are there cost saving that can be achieved or new revenues produced by doing the project sooner?

b) Are the cost savings or new revenues sufficient to offset the additional carrying costs of the debt?

2) Does HRM have the staff capacity to deliver the projects in the expected time frame?

HRM is facing considerable internal capacity limitations in completing the already approved capital projects. Current estimates are that 67% of capital projects approved are complete meaning 33% of existing capital project dollars approved are outstanding. Additional capital project managers and other support staff are being added this year to move projects through to completion on a more timely basis but the fact remains that staff resources cannot keep up with the projects that have already been approved. In addition, any time debt is used as a funding source there are interest costs. There may be specific situations when Council may consider incurring additional debt on a case by case basis, using these or other revenue sources and where the general criteria outlined above are met. However, staff believe that in the absence of these criteria, using these revenues as a source of funds to pay debt charges will only result in the new revenues being diminished by the interest costs related to the debt with no improvement to the financial well being of HRM as a result of trying to advance the projects faster. Therefore it is not recommended that these revenues be included as a general source of funds to authorize more debt as part of the Debt Policy. Council or staff can always consider exceptions when the circumstances warrant.

BUDGET IMPLICATIONS

There are no 2008/09 budget implications as a result of the recommendations. The revised Policies are recommended to be in place for two years or until the new MYFS is brought to Council along with a new Debt policy during 2009/10. The recommended revisions to the Policy will ensure that HRM's net debt funded from the general rate will continue to decline for the next two years. The additional capital projects that can be supported by the additional debt capacity must meet the criteria contained in the Service Improvement reserve and will therefore create efficiencies.

FINANCIAL MANAGEMENT POLICIES / BUSINESS PLAN

If the recommendations are approved, this report will result in a revision to the Capital Debt Policy and Debt Servicing Plan contained in the Municipality's Multi-Year Financial Strategy. Other than this impact the report complies with the remainder of the MYFS, the approved Operating, Capital and Reserve budgets, policies and procedures regarding withdrawals from the utilization of Capital and Operating reserves, as well as any relevant legislation.

ALTERNATIVES

1. Regional Council could leave the existing Capital Debt Policy as it is with no revisions.

2. Regional Council could make changes to the Capital Debt Policy other than the ones recommended in this report.

ATTACHMENTS

Attachment 1 - Appendix A - Existing HRM Capital Debt Policy & Debt Servicing Plan
Attachment 2 - Appendix B - Proposed Revised HRM Capital Debt Policy & Debt Servicing Plan

A copy of this report can be obtained online at http://www.halifax.ca/council/agendasc/cagenda.html then choose the appropriate meeting date, or by contacting the Office of the Municipal Clerk at 490-4210, or Fax 490-4208.

Report Prepared by:	(Original Signed) Bruce Fisher, Manager, Fiscal and Tax Policy, Finance 490-4493
Financial Approval by:	(Original Signed) Catherine Sanderson, Senior Manager, Financial Services, 490-1562
Report Approved by:	(Original Signed) Dale MacLennan, Director of Finance 490-6308

Appendix A

HRM Capital Debt Policy

(17) Debt can only be issued in compliance with all appropriate provisions contained within the Municipal Government Act and with the CAO's recommendation and Council's approval.

(18) The Director of Finance will be responsible for administering capital debt and this policy.

(19) A capital Debt Servicing Plan with a five year debt projection will form an integral part of the annual budget. The Debt Servicing Plan will include an upper and lower limit.

(20) The CAO will provide Council with a report annually in conjunction with the capital budget as to the total capital debt issued and approved.

(21) Debt funding will be restricted to items with a life expectancy of at least 10 years. This clause will be phased in over a period of not more than five years.

(22) Debt for a specific capital project will be issued for a period not longer than the expected life of the asset.

(23) The dollar amount of new issued debt funded from the general tax rate will be limited to the debt being retired in the same year less a reserve for debt retirement or a notional reserve for non-amortizing debt obligations.

(24) Capital Debt will be segregated in the Accounting records which shall ensure the maintenance of accurate information with respect to the purpose, issuance and retirement.

(25) The capital debt policy will be reviewed annually in conjunction with the budgeting process.

Debt Servicing Plan

Principal 6 of the Principles of Financial Management, unanimously adopted by Council in December 1998, reads:

<u>Principal 6</u>
Council and Management will develop and adopt a sustainable plan for reducing debt servicing.

- *Develop five year upper and lower limits consistent with the goals established for debt servicing and operate within these limits which will be reviewed annually.*
- *Review the Debt Servicing Plan every year.*

The five year Debt Servicing Plan is devised with the following assumptions:

- Current net debt funded from the general tax rate will reduce every year.
- New issued debt to be funded from the general tax rate will be limited to the debt being retired less a reserve for debt retirement or a notional reserve for non-amortizing debt obligations.
- The upper limit for debt funded from the general tax rate will be the net debt position at the end of the previous year.
- The lower limit for net debt funded from the general tax rate to March 31, 2004 will be $300 million.
- The reserve for debt retirement will be 20% of the debt retired in the same year.
- 100% of the Capital budget funded by debt will be debentured.

Over the five years ended March 31, 2004, based on the assumptions above, the following results will occur:

Total reduction in net debt:	$45.7 million
Per centage reduction in net debt:	13.2%
Net debt at March 31, 1999	$347.5 million
Net debt at March 31, 2004	$301.8 million

Appendix B

Proposed Revised
HRM Capital Debt Policy

(3) Debt can only be issued in compliance with all appropriate provisions contained within the Municipal Government Act and with the CAO's recommendation and Council's approval.

(4) The Director of Finance will be responsible for administering capital debt and this policy.

(5) A capital Debt Servicing Plan with a five year debt projection will form an integral part of the annual budget. The Debt Servicing Plan will include an upper limit.

(6) The CAO will provide Council with a report annually in conjunction with the capital budget as to the total capital debt issued and approved.

(7) Debt funding will be restricted to items with a life expectancy of at least 10 years.

8. The dollar amount of new issued debt funded from the general tax rate will be limited to the debt being retired in the same year less a target for debt reduction.

9. Capital Debt will be segregated in the Accounting records which shall ensure the maintenance of accurate information with respect to the purpose, issuance and retirement.

10. The capital debt policy will be reviewed annually in conjunction with the budgeting process.

Debt Servicing Plan

Principal 6 of the Principles of Financial Management, unanimously adopted by Council in December 1998, reads:

<u>Principal 6</u>
Council and Management will develop and adopt a sustainable plan for reducing debt servicing.

- *Develop five year upper and lower limits consistent with the goals established for debt servicing and operate within these limits which will be reviewed annually.*

- *Review the Debt Servicing Plan every year.*

Revised Debt Servicing Plan

The five year Debt Servicing Plan is devised with the following assumptions:

- Current net debt funded from the general tax rate will reduce every year.

- New issued debt to be funded from the general tax rate will be limited to the debt being retired less a target for debt reduction.

- The upper limit for debt funded from the general tax rate will be the net debt position at the end of the previous year.

4. The target for debt reduction will be 15% of the debt retired in the same year. The additional debt capacity that is created by reducing the original target for debt reduction from 20% to 15% of the debt retired in the same year will be applied to those capital projects which meet the criteria of the Service Improvement Reserve. If no such project is available in any given year or as Council determines, then this debt capacity can be used instead to further reduce debt.

5. 100% of the Capital budget funded by debt will be debentured.