HALIFAX

P.O. Box 1749
Halifax, Nova Scotia
B3J 3A5 Canada

Item No. 14.2
Halifax Regional Council
September 23, 2014

TO: Mayor Savage and Members of Halifax Regional Council

Original Signed

SUBMITTED BY: ______________________________
Councillor Bill Karsten, Chair, Audit & Finance Standing Committee

DATE: September 18, 2014

SUBJECT: Debt Guarantee Provided to Halifax Regional Water Commission by HRM

ORIGIN

September 17, 2014 Audit & Finance Standing Committee meeting, Item No. 9.1.3.

LEGISLATIVE AUTHORITY

Audit and Finance Standing Committee Terms of Reference section 3.2.6 which states "Review , as required, any other policies, procedures, forecasts, reports or process as agreed to mutually by the Municipality's CAO and the Committee

RECOMMENDATION

The Audit & Finance Standing Committee recommends to Halifax Regional Council that all debt issued by the Nova Scotia Municipal Finance Corporation on behalf of the Halifax Regional Water Commission be guaranteed by the Halifax Regional Municipality subject to the Water Commission maintaining a debt service ratio of 35% or less.

BACKGROUND

A staff report dated September 2, 2014 was before the Audit & Finance Standing Committee pertaining to a Debt Guarantee provided to the Halifax Regional Water Commission from HRM, as required by the Municipal Finance Corporation, to secure loans for capital projects in excessive of $70 million.

Further details are provided in the attached staff report dated September 2, 2014.

DISCUSSION

Staff responded to questions from the Audit & Finance Standing Committee pertaining to the proposed debt service ratio and the assumed risk to the municipality in guaranteeing debt. Staff noted that the requested debt service ratio of 35% is justified as debt servicing costs for water services are entirely accommodated within the Halifax Regional Water Commission's approved rates. Staff further noted that risk is low because of a stable and secure demand for water services, predictive revenue streams and the required approval of the Nova Scotia Utility and Revue Board for capital projects undertaken by Halifax Water.

The Audit & Finance Standing Committee, having reviewed this matter at its September 17, 2014 meeting, forwarded the recommendation as outlined in this report.

FINANCIAL IMPLICATIONS

As outlined in the attached staff report dated September 2, 2014.

COMMUNITY ENGAGEMENT

All meetings of the Audit & Finance Standing Committee are open to the public. The reports

ENVIRONMENTAL IMPLICATIONS

There are no environmental implications associated with this report.

ALTERNATIVES

The Audit & Finance Standing Committee did not discuss alternatives. Alternative recommendations are outlined in the attached staff report dated September 2, 2014.

ATTACHMENTS

1. Staff report dated September 2, 2014.

A copy of this report can be obtained online at http://www.halifax.ca/council/agendasc/cagenda.php then choose the appropriate meeting date, or by contacting the Office of the Municipal Clerk at 902.490.4210, or Fax 902.490.4208.

Report Prepared by: Liam MacSween, Legislative Assistant, 902-490-6521

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Attachment 1

Audit & Finance Standing Committee
September 17, 2014

TO: Chair and Members of Audit & Finance Standing Committee

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SUBMITTED BY: ______________________________

Greg Keefe, Director of Finance & ICT/CFO

DATE: September 2, 2014

SUBJECT: **Debt Guarantee Provided to Halifax Regional Water Commission by HRM**

ORIGIN

Request from the Halifax Regional Water Commission.

LEGISLATIVE AUTHORITY

Charter section 74 (1) The Municipality may agree with one or more ... service commissions ... to provide or administer municipal or village services. 74 (4) Where an agreement made by the Municipality pursuant to subsection (1) creates a body corporate (b) the Municipality may guarantee its borrowings.

RECOMMENDATION

It is recommended that the Audit & Finance Standing Committee recommend to Halifax Regional Council that all debt issued by the Nova Scotia Municipal Finance Corporation on behalf of the Halifax Regional Water Commission be guaranteed by the Halifax Regional Municipality subject to the Water Commission maintaining a debt service ratio of 35% or less.

BACKGROUND

On July 31, 2014, the Halifax Regional Water Commission (HRWC) Board approved a staff recommendation that HRM be formally requested to provide a blanket guarantee of all HRWC debt. The HRWC staff recommendation report is included as Attachment 1 to this report. The Nova Scotia Municipal Finance Corporation (MFC) indicated its support for the request in a letter to the HRWC. A copy of the letter is included as Attachment 2 to this report.

Currently, HRWC can borrow up to $70 million from the MFC without any guarantee from HRM. The HRWC contends that the requirement for it to seek a municipal guarantee for borrowing in excess of the $70 million cap is an unnecessary additional administrative step given that the Water Commission's capital budgets and debenture issues are reviewed and approved by its Board and the Nova Scotia Utility and Review Board (NSURB).

DISCUSSION

Capital Borrowing Guidelines for Nova Scotia municipalities restrict the gross debt service ratio to 30% of property tax and own source revenue. Self-supporting utilities, such as the HRWC, are exempt from this requirement. However, HRWC has a debt policy which restricts the debt service ratio to a maximum of 35%. The Water Commission believes the higher ratio is justified as regulated utilities engage in a capital intensive business, debt servicing costs are entirely accommodated within approved rates, and risk is low because of a stable and secure demand for their services. As of March 31, 2014, the Water Commission's debt service ratio was 23%. As part of its debt strategy, the HRWC also targets to keep its debt/equity ratio at or below 40%/60%. As of March 31, 2014, the debt/equity ratio was about 20%/80%.

The HRWC is closely regulated by the NSURB. The NSURB approves the Water Commission's capital budget and all debt issuance as well as individual capital projects in excess of $250,000. The HRWC must report to the NSURB on the completion of capital projects. In rate applications to the NSURB, the HRWC must include the cost of debt servicing. This ensures that the HRWC has the revenue required to meet its debt payments as they come due.

In summary, the low risk associated with regulated utilities combined with the level of oversight provided by the NSURB should provide Council with the assurance that providing the HRWC with a blanket guarantee for all its MFC issued debt is of minimal risk to HRM. No longer requiring the HRWC to obtain a guarantee from HRM for borrowings above the $70 million cap will eliminate an unnecessary step thereby improving operating flexibility and administrative efficiency, and reducing delays resulting from the need to seek approvals from Council.

The MFC has indicated its support for a blanket guarantee in a letter to the HRWC included as Attachment 1 to this report.

FINANCIAL IMPLICATIONS

There are no financial implications resulting from the recommendations in this report. The HRWC is entirely responsible for covering its debt payments from revenues derived from NSURB approved rates.

Requiring a municipal guarantee may be redundant as it does not affect the cost of borrowing and the HRWC is a commission of HRM and as such its financial statements are consolidated with those of HRM. In the unlikely event of a default, as the owner, HRM would be responsible for all HRWC debt, regardless of whether it is covered by a blanket guarantee or not.

COMMUNITY ENGAGEMENT

Not applicable.

ENVIRONMENTAL IMPLICATIONS

There are no environmental implications resulting from the recommendations in this report.

ALTERNATIVES

Regional Council could refuse the Water Commission's request for a blanket guarantee. This is not recommended as it would continue to add an unnecessary step in the issuance of MFC debt to support the HRWC capital program.

ATTACHMENTS

Attachment 1: Report to HRWC Board dated July 17, 2014 entitled "Blanket Debt Guarantee"

Attachment 2: Letter to Cathy O'Toole, Director of Finance/CFO of HRWC from Bob Houlihan, CEO/ Treasurer of Nova Scotia Municipal Finance Corporation

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A copy of this report can be obtained online at http://www.halifax.ca/commcoun/index.php then choose the appropriate Community Council and meeting date, or by contacting the Office of the Municipal Clerk at 490-4210, or Fax 490-4208.

Report Prepared by: Gordon Roussel, Senior Financial Consultant, 490-2500

Original Signed

Report Approved by: ______________________________

Bruce Fisher, Manager, Financial Policy and Planning, 490- 4493

Original Signed

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Financial Approval by: Greg Keefe, Director of Finance & ICT/CFO, 490-6308

Halifax Water
Halifax Regional Water Commission

Attachment 1

HRWC Board
July 31, 2014

TO:	Colleen Purcell, C.A., Chair, and Members of the Halifax Regional Water Commission Board
SUBMITTED BY:	Original Signed Cathie O'Toole, CGA, MBA Director of Finance & Customer Service
APPROVED:	Original Signed Carl Yates M.A.Sc., P.Eng., General Manager
DATE:	July 17, 2014
SUBJECT:	**Blanket Debt Guarantee**

ORIGIN

Municipal Finance Corporation Cap for Unguaranteed HRWC Debt

RECOMMENDATION

That the Halifax Regional Water Commission Board approve HRWC formally requesting that the Halifax Regional Municipality approve a blanket guarantee of HRWC Debt, subject to the conditions described in this report.

BACKGROUND

HRWC developed a Debt Strategy pursuant to a NSUARB Order in 2010; that was accepted by the NSUARB in June 2013. It was viewed a as positive outcome, but not formally approved due to uncertainties around the impact of a future Regional Development Charge and availability of Federal/Provincial infrastructure funding.

Capital Borrowing Guidelines for Municipal Units in NS establish a guideline restricting gross debt service ratio to 30% of property tax and own-source revenues. Self-supporting utilities are exempted.

HRWC's debt policy establishes a maximum debt service ratio of 35%. The higher ratio is warranted given 1) there is a lower level of risk for a regulated utility, 2) it is an infrastructure intensive business, 3) and HRWC's debt servicing payments are fully accommodated within HRWC's approved rates. Debt servicing is used to fund assets within the rate base.

Essentially, because demand for water, wastewater and stormwater services is relatively stable and secure and rates are regulated, there is low risk in terms of liquidity or ability to service debt.

DISCUSSION

All HRWC debt issuance must be approved by the HRWC Board, and the NSUARB. Debt servicing is approved as part of revenue requirements (rates). The NSUARB approves HRWC's capital budget, and HRWC must report on completion of capital projects. The NSUARB also approves individual capital projects in excess of $250 k.

All borrowing is done through the Municipal Finance Corporation (MFC) and the MFC currently has a cap for unguaranteed debt for HRWC set at $70 M. Any debt in excess of the cap must be guaranteed by HRM.

A cap for HRWC's unguaranteed debt was first established in 1999, and meant that up to a certain limit, HRWC can borrow without a guarantee from HRM. As the utility grew, the cap for unguaranteed debt was increased as follows:

1999 – Cap set at $15 Million
2002 – Cap increased to $25 Million
2006 – Cap increased to $35 Million
2011 – Cap increased to $70 Million

All debt issued by the MFC is backed by Provincial guarantees. Requiring the municipality to guarantee a certain amount of the utility's debt reduces the Provincial guarantee risk.

On February 4, 2014 a presentation was made to the MFC Board, with respect to the cap, HRWC's Debt Study, and future debt requirements to finance unavoidable infrastructure requirements.

It is unclear whether the cap still serves a purpose, as accounting guidelines have changed since its establishment, and existence of a municipal guarantee does not impact the cost of borrowing or credit ratings for the various levels of government. Further, as Halifax Water is a regulated utility with over a billion dollars of assets and 98.7% of its revenues coming from regulated sources, Halifax Water is extremely low risk.

Section 17 (4) of the Municipal Finance Corporation Act states that "The Corporation may, by order of the Board, seize and sell property of a municipal enterprise to recover any amount in default, and for this purpose a loan by the Corporation to a municipal enterprise is a charge upon the property of the municipal enterprise." The requirement for Halifax Water to seek a municipal guarantee creates an unnecessary additional administrative step, given that Halifax Water's capital budgets and debenture participation are reviewed and approved by the Halifax Water Board and the Nova Scotia Utility and Review Board.

In summary, the reasons the HRWC requests a blanket exemption are:

- HRWC is unique as the only agency allowed to borrow through the MFC that is subject to a cap on unguaranteed debt

- It is unclear whether the cap imposed for Unguaranteed Debt still serves a purpose as Accounting guidelines/PSAB have changed

- HRWC financial statements are consolidated with HRM, and is controlled by HRM, so a municipal guarantee may be redundant

- HRWC is low risk, due to regulation and the fact that debt servicing is included in the utility rates

- A municipal guarantee provides no reduction in HRWC's cost of borrowing

- The cap negatively impacts operating flexibility and administrative efficiency. HRWC has approximately $6 million in capacity under the cap. If the cap is not addressed there will either be more frequent guarantee approvals sought at HRM Council.

Following the February 4, 2014 meeting, the MFC Board discussed the issue at their April 17, 2014 meeting and provided direction to HRWC (letter attached) that HRWC should seek a blanket guarantee from HRM.

It is recommended that HRWC request a Blanket Guarantee from HRM that would guarantee all utilization of debt; subject to HRWC maintaining a debt service ratio of 35% or less. This request, if approved by the HRWC Board, would go to HRM's Audit and Finance Committee, then to HRM Council.

In October 2012 a Debt Strategy was presented to the HRWC Board, and subsequently filed as part of the December 2012 Rate Application. The debt strategy report concludes that some appropriate ratios for HRWC to utilize are:

1. Target Debt Service Ratio of 35%
2. Target Debt/Equity Ratio of 40%/60%

In essence, the two targets will serve as a framework for HRWC's strategy when considering future use of debt. As at March 31, 2014 HRWC had $215,103 in outstanding debt. The debt service ratio was 23%, and total capital under management was $1,044,189,000 with 20% funded by debt and 80% funded by equity. HRWC has sufficient room with the targets to utilize debt to fund future capital requirements, but may be constrained in terms of rate affordability. Increasing the capital program to reach Integrated Resource Plan levels must occur gradually to phase in new debt service and depreciation expenses.

Intervenors put forward arguments indicating a preference for HRWC to take a less conservative approach with respect to utilization of debt. In the June 24, 2013 NSUARB Decision on the General Rate Application, the NSUARB expressed concern about constraints on HRWC's ability to utilize debt.

4.3 Findings

[89] The Board is concerned the results of the Debt Study may have been influenced by "constraints" imposed by other parties. A better process would have been to independently analyze scenarios more reflective of normal commercial constraints to arrive at a recommended debt strategy. However, the Board is aware that HRWC operates in an environment with imposed restrictions.

[90] The Board's main concern with respect to borrowings is that costs are minimized to ratepayers. The argument with respect to the benefit to customers at various levels of debt appears to be highly dependent upon interest and discount rates applied and that these two factors can vary widely over time.

[91] It also appears that there are many assumptions in the scenario analysis, in particular with respect to funding from the RDC and depreciation from contributed assets. The Board notes that HRWC is continuing its stakeholder consultation with regard to the RDC in advance of an application expected to be filed with the Board later this year.

[92] The Board views the Debt Study as a positive step in looking at an efficient funding mechanism for HRWC. The Board accepts the Debt Study as presented. However, given the level of assumptions and uncertainty, the Board is not prepared to approve a particular scenario at this time.

BUDGET IMPLICATIONS

The existence of a blanket guarantee by HRM will not result in lower financing costs. The existence of a blanket guarantee, or separate debt issuance guarantees in future will impact HRWC' ability to partially finance the capital program with debentures. Utilization of debt financing is required to meet the capital requirements identified in the Integrated Resource Plan; and to finance capital in a cost effective manner that is mindful of rate affordability.

ALTERNATIVES

1) HRWC could individually request guarantees for each Spring or Fall Debenture issue. This introduces additional complexity and redundancy in terms of approvals, as the HRWC Board, the HRM, and the NSUARB would each have to approve; and the three timelines would have to be managed to ensure the approvals are in place in time to meet the Municipal Finance Corporation debenture process deadlines.

2) The HRWC Board could request a blanket guarantee with conditions different than those disclosed in this report.

ATTACHMENTS

April 2014 Letter from Municipal Finance Corporation

Original Signed

Report Prepared by: ______________________________
Cathie O'Toole, CGA, MBA, Director of Finance, 490-3572

Attachment 2

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Nova Scotia
Municipal Finance Corporation

Cathie O'Toole,
Director of Finance/CFO
Halifax Regional Water Commission
450 Cowie Hill Road
PO Box 8388, RPO CSC
Halifax, NS B3K 5M1

Dear Ms. O'Toole:

Thank you for your presentation to the Nova Scotia Municipal Finance Corporation's Board of Directors on February 4, 2014. At that meeting, the Board discussed your presentation and requested additional information which was provided to them at their April 17, 2014 meeting.

After further discussion, the Board of Directors passed a motion changing their policy for HRWC from $70 million cap on unguaranteed debt to the option in your presentation requiring a blanket guarantee for all future Halifax Water debt.

If you have any questions, please do not hesitate to contact me at [redacted] or by email at [redacted].

Yours truly,
Original Signed

Bob Houlihan, CGA
CEO/Treasurer