Debt and Reserves

Presentation to Audit and Finance | January 16, 2013

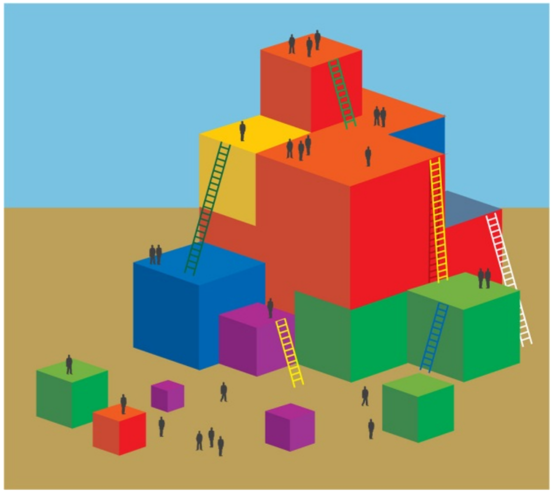
Outline

- **Debt**
  - Capital Budget Concepts
  - Background to Debt Policy
    - Targets and Trends
- **Reserves**
  - Draft Framework and Approach

Capital Budget Concepts

1. **Purchase the Asset**
   - Debt
   - Capital from Operating/Reserves
   - Other Funding
2. **Operate the Asset**
   - Pay for Debt Charges
   - Staff, Utilities, Fuel, etc.
3. **Maintain the Asset**
   - “State of Good Repair” Projects
     - Maintenance Reserves
   - Operating Budget
4. **Replace the Asset**
   - Growth and Service Improvement Projects
     - Replacement Reserves

Home for Sale		HRM Budget
Cost is **$180,000**	→	Capital Budget
We've **saved** $20,000	→	Reserves
Can **put down** another $10,000	→	Capital from Operating ("Pay As You Go")
So, a $150,000 **mortgage**	→	Debt



Cost to heat is **$3,000 each year**	→	Operating Cost of Capital
Mortgage payments are $10,500 per year	→	Debt Charges
Roof needs to be fixed	→	State of Good Repair
We want to add a **garage**	→	Service Improvements, Growth

About Debt

- **HRM budgets for both Principle and Interest costs**
- **Debt is simply a financial tool.**
  - Low Debt may mean
    - assets are deteriorating
    - cost of maintaining assets are increasing
    - we are losing out on opportunities.
  - High Debt may place financial pressure on future tax rates.
    - Creates risk and uncertainty
    - Rating Agency concerns
- **HRM has capacity to borrow, however**
  - Because we can, does not mean we have to borrow

About Debt

- **Debt is always more expensive than Capital from Operating.**
  - In the short-run, it is difficult to increase Capital from Operating
- **Additional debt charges may be less than higher operating costs from older assets**
- **We need to consider**
  - Whether we will lose opportunities
  - Trend in interest rates
  - Trend in construction costs

How HRM Defines Debt

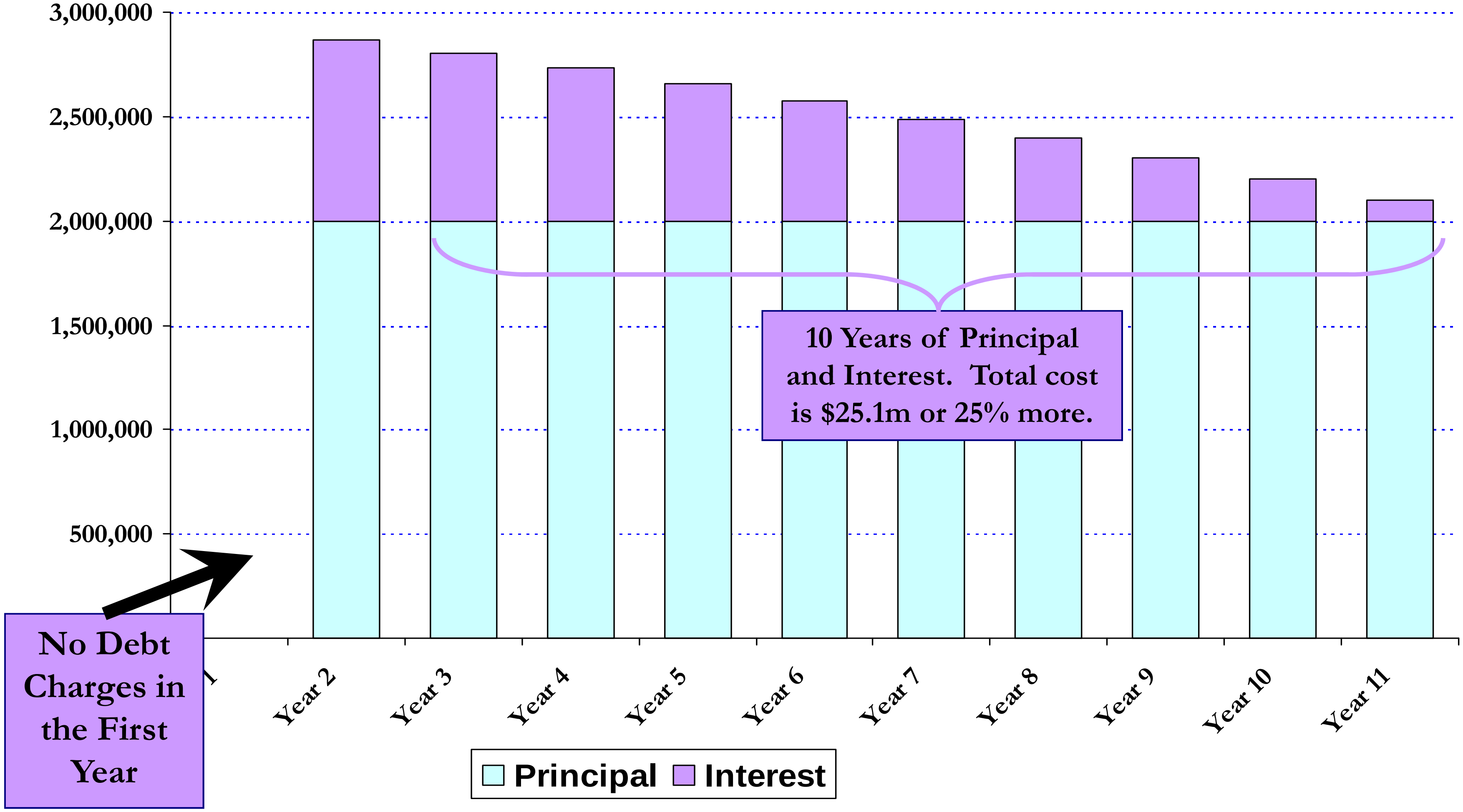
1. **Tax Supported Debt**
    - Paid for by General and Transit Tax Rates
        - Includes Capital Leases
2. **Other HRM Debt**
    - Paid for by Area Rates, LICs, CCC, Reserves
3. **HRWC Debt**
    - Paid for by Water Rates, Pollution Control Charge (PCC)
4. **Repayable Debt**
    - Paid for by other organization (Eg Major Facilities, Metro Centre)
    - Effectively a guarantee by HRM

Note: Debt Policy covers issued debt and debt not yet issued but approved by Council.

Why Have Debt Targets

- **Healthy use of debt allows us to grow**
  - Allows us to take advantage of opportunities when they arise
- **Experience from early years of amalgamation was discipline helped improve our finances.**
- **Continuous debt financing leads to greater pressure on budgets and hence tax rates.**
  - Debt has long term impacts

Example of $20m in Debt



What is our Objective

- **Grow the Capital Budget while**
  - Reducing reliance on debt, and,
  - Increasing capital from operating
- **The concept is to eventually**
  - Have all ongoing State of Good Repair funded through Capital from Operating or Reserves
  - Use Debt only for Growth or Service Improvement

Debt Targets (2010-11 to 2014-15)

- **The Debt Servicing Plan targets were set by Council as:**
  - **Tax Supported Debt** should decline by minimum 3% per year
  - **Capital from Operating** should increase by minimum 3% per year after the Consumer Price Index (CPI)
- **Exceptions to targets**
  - For major funding opportunities
  - Within the spirit of the policy

Exceptions

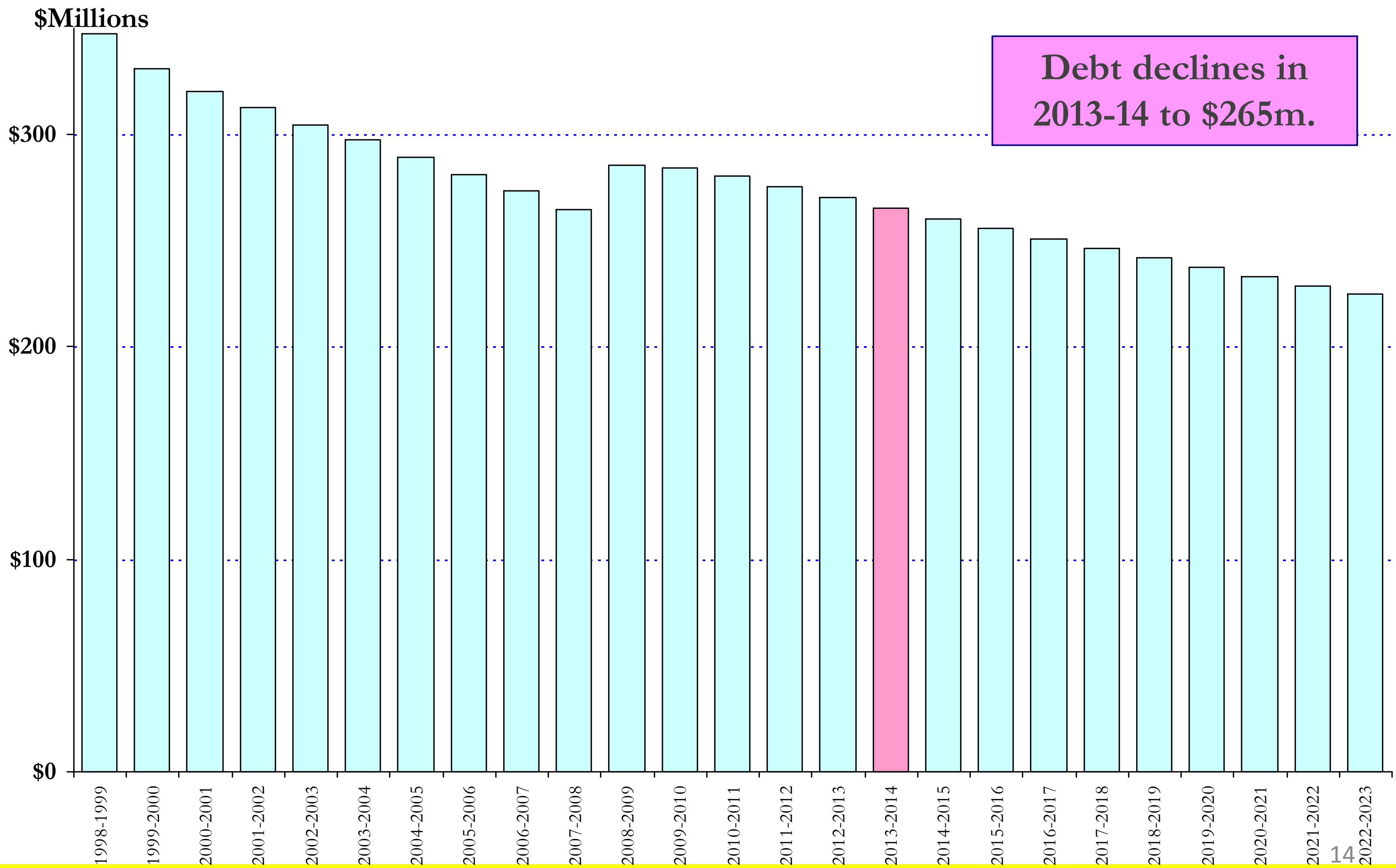
- **Is it in the best interest of HRM's long-term financial health to borrow funds to advance projects faster than would otherwise be possible under the Capital Debt Policy?**
  - Are there cost saving that can be achieved or new revenues produced by doing the project sooner?
  - Are the cost savings or new revenues sufficient to offset the additional carrying costs of the debt?
- **Does HRM have the capacity to deliver the projects in the expected time frame?**

Debt Targets

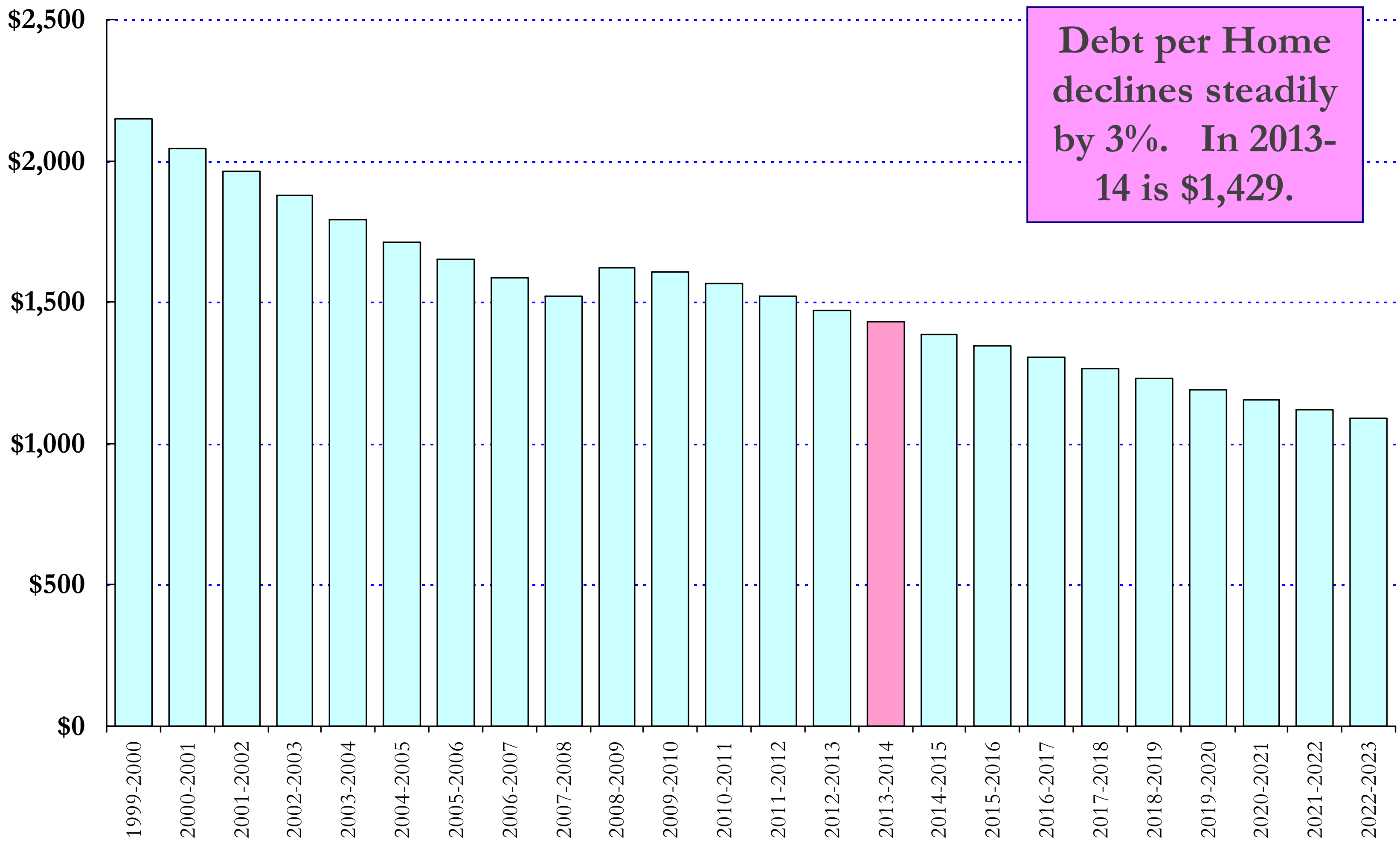
	Year 1 2013-14	Year 2 2014-15	Year 3 2015-16
Tax Supported Debt ($m)	265.2	260.3	255.6
- Amount per Home	1,429	1,386	1,345
New Debt to be Approved ($m)	30.4	32.6	34.3
Capital from Operating ($m)	42.7	45.4	47.7
- Amount per Home	230	242	251

Note: Five year targets approved by Council for up to 2014-15.

Tax Supported Debt ($ millions)



Tax Supported Debt per Dwelling



Other Debt Pressures

- **Council is free to revise its debt targets. Staff review considered:**
  - Business Parks to issue debt and repay through sales of land. In past has paid up-front.
  - Debt may be issued for LED streetlights
  - HRWC has a 30 year Integrated Resource Plan totaling $3.8 billion. (Peak of $500m in debt).
  - Possible business case to go outside debt targets for Cogswell Interchange

Reserves

- **Reserves are funds set aside for a specific purpose. Similar to how an individual might create a savings account for a specific purpose.**
- **An important part of the operating and capital budgets.**

Council's Reserve Policy (1998)

- **Halifax Charter provides legal structure around reserves.**
  - Reserves may be equipment, operating or capital.
- **Council policy requires that each Reserve have an approved Business Case with purpose, source and use of funds and timeline.**
- **Currently, HRM has approximately 50 reserves.**

Reserve Framework

- **No overall review of reserves has occurred since creation of policy.**
- **There is a need to review reserves and ensure they fit within a long term operating and capital plan.**
  - Only certain types of situations have to have a reserve, others can be funded through regular budget process.
  - Some reserves may no longer be required, Others may need to be created.
  - Work is underway and will return with the Budget.

Purpose of Reserves

- **To ensure the Municipality has the ability to fund projects and events**
  - that produce clear, long-term efficiency gains
  - that are strategic and/or require significant cost sharing
  - between budget approvals where there is sudden, unexpected opportunity
  - where future obligations can be reasonably foreseen
  - where substantial risk may occur

Proposed Approach to Creating Reserves (draft)

- **Reserves could be used for**
  - To provide contingency funds for Future **Opportunities**
  - To help offset financial **Risks**
  - To provide funding for future **Obligations**.

Contingencies for **Opportunities**

- **To provide funds for financial, economic or service opportunities.**
  - Because such opportunities are typically uncertain, these funds should be mostly corporate wide. May combine a number of reserves into:
    - Strategic Growth Reserve
    - Service Improvement becomes Service Efficiency Reserve
    - Service Opportunity Reserve for items between budgets

Contingencies for **Risks**

- **To provide funds for protection against risks that can be clearly estimated based on assumptions.**
  - Many services face broad categories of risk and should be corporate:
    - Operating Stabilization Reserve
    - Economic Adjustment
    - Insurance Reserve
  - Other risk factors may be specific to a service:
    - Snow and Ice Reserve
    - Police Officer on the Job
    - EMO

Contingencies for **Obligations**

- **To provide funds for future obligations.**
  - Where the obligation cannot be estimated, the fund should be corporate:
    - Sale of Land Reserve
    - Capital Surplus
  - If there is a specific and detailed lifecycle plan, asset plan or funding plan, a reserve may be geared to that service:
    - Metro Park Parkade
    - Waste Resources
    - Municipal Elections
    - Central Library Repayment Reserve

Reserve Review Continues

- **Work continues to finalize a written Reserve Framework for 2013-14.**
- **Finalize recommendations on new, modified and eliminated reserves.**
  - Bring forth business cases and supporting documents
  - Move funding between reserves, including supporting Multi-District Facility Reserve
- **Move 2012-13 surplus ($13m) into reserves for future projects**
  - Includes $7.3m to Proposed LED Streetlight Reserve

Reserve Review Continues

Draft

New Reserves

Service Opportunity ($1m maximum)	$1m maximum for service opportunities within budget year
Research Reserve	to provide central funds to research studies that take more than 1 budget year to complete
Economic Adjustment	for economic downturn
Streetlight Conversion to LEDs	to manage transition to LED lights, includes capital, operating and debt charges. Funding from 2012-13 surplus.
Convention Centre Reserve	to pay for obligations for new convention centre
Bus Replacement Reserve	to fund bus replacement
Multi-District Facilities Reserve	for service enhancements to Multi-District Facilities

Note: Possible new Reserves for specific major assets and asset classes, integrated into long term asset plans and project budget

Reserve Review Continues

Draft

Modified Reserves	
Service Improvement Reserve Sustainable Community Information and Communications Technologies	becomes "Service Efficiency Reserve", expenditures based on business cases. Grants not loans.
Snow & Ice Control Variable Operating	adjustment to required balance with excess to new Multi-District Facility Reserve (MDFR)
Operating Stabilization	adjustment to required balance with excess to new Multi-District Facility Reserve (MDFR)
Rural Fire	Requires review to determine future obligations and whether they should be reserved or included in long term capital
Business/Industrial Parks Expansion	Withdrawals to operating budget should be limited to costs incurred to make sales.

Reserve Review Continues

Draft

Eliminated Reserves	
Major Events Facilities	obligations to Strategic Growth
Culture Development	obligations to operating/capital budget process
Energy and Underground Services	obligations to Service Opportunity
DNA Cost (HRP and RCMP	obligations to operating budget
Community Facility Partnership	
Kingswood Water	
Capital Replacement	
Operating Cost of New Capital	no new funds, budget process to include future operating requirements
Fuel Systems	

Questions, feedback

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