Enclosure 2

STRATHCONA COUNTY

Policy

Debt Management

References: *Municipal Government Act*, RSA 2000, c M-26 (MGA)

Policy Statement

Strathcona County ~~will only incur new debt when it is consistent with the Strategic Plan direction and objectives. This policy provides the framework and guiding principles for the management of long-term debt. Long-term debt is a source of funding used to support capital project expenditures and is incurred to allow the County to address:~~

~~1. The protection of existing facility, roadway and underground capital infrastructure (i.e. replacement requirements).~~
~~2. The addition of new capital infrastructure resulting from growth and/or changes in service levels (i.e. community demands).~~
~~3. Emergent capital initiatives as they arise.~~recognizes that, properly applied, debt can be an affordable source of financing that complements the sustainability of an organization and helps to achieve service provision and growth objectives. The incurrence of Long-Term Debt is generally appropriate as the beneficiaries (future users) of the capital infrastructure funded by the Long-Term Debt will then share responsibility for the future repayment of the Long-Term Debt. The foundation of any well managed Debt program is a comprehensive Debt policy which sets forth the parameters for issuing Debt and managing outstanding Debt, and provides guidance to decision makers.

~~The incurrence of long-term debt is generally appropriate as the beneficiaries (future users) of the capital infrastructure funded by the long-term debt are responsible for the future repayment of the long-term debt.~~

~~Debt will be subject to a management plan and policies that will establish guidelines to address the management of long-term debt. The following elements are integral to an effective debt management plan:~~

~~1. Effective debt management is critical to the overall financial management of the County; incurring new debt must be affordable and manageable.~~
1. Debt is an ongoing component of Strathcona County's capital financing structure and is integrated into the County's long-term plans and strategies.
~~2. The use of debt management is a useful and effective tool in the achievement of the overall growth and service provision objectives of the County.~~
2. Debt must be affordable and support the sustainability of the Municipality. The County must maintain flexibility to utilize Debt in response to emerging financing needs.
~~3. The ability to meet debt service requirements acts as the overall ceiling on capital program expansion.~~
3. Debt must consider intergenerational equity and be structured in a way that is fair and equitable to those who pay and benefit from the underlying assets over time.
~~4. The focus of an effective debt management plan should be on debt "management" as opposed to debt "reduction". Debt reduction is a component but should not be viewed as the sole driver of an effective debt management policy.~~
4. The issuance of new Debt must be approved by Council.

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~~5. An effective debt management plan should also focus on debt "avoidance" as a component of an effective debt management policy. In this regard, the link to and management of reserves is an important factor in debt management.~~

5. Debt must be monitored and reported upon.

~~An effective debt management plan needs to be flexible in order to address emergent initiatives and take advantage of (special) debt principal repayment opportunities.~~

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Purpose

The purpose of this policy is to establish financial guidelines and controls for the issuance and use of new Debt and to ensure a favourable financial position while supporting the County's ability to meet current and future infrastructure requirements including replacement, new growth, and emergent capital initiatives.

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Definitions

~~1. **Business Case** refers to an analysis that demonstrates the necessity for and viability of a new project. A business case will include a financial analysis and a financial plan that identifies and confirms sources of funding to provide for the financing of the capital and operating costs of a new project.~~

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1. **Affordability** – means ability to pay for Debt Servicing costs and life cycle expenditures for the underlying asset. The overall measure of affordable Debt is the burden of Debt Servicing costs and the life cycle expenditures relative to the County Revenues. The Debt Service Ratio measures Debt Servicing costs against net operating income and is a benchmark used to determine affordability.

~~2. **Capacity** refers to the difference between the amount of projected year-end debt as calculated by applying the ceiling percentage to the projected annual total operating revenues less the amount of current year-end debt based on current approved debt levels.~~

2. **Alberta Capital Financing Authority (ACFA)** refers to the non-profit corporation established under the authority of the *Alberta Capital Finance Authority Act*, to provide Alberta local authorities with flexible financing for capital projects.

~~3. **Ceiling** is stated as a percentage and refers to the maximum percentage that the annual year-end debt outstanding can be of the debt limit.~~

3. **Authorized Borrowing Bylaw** – As per the Municipal Government Act (MGA) section 251(1), a municipality may only make a borrowing if the borrowing is authorized by a borrowing bylaw.

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~~4. **Debt Avoidance** refers to the setting aside of funds for the purpose of having funds on hand in reserve to finance capital projects that would otherwise be financed by incurring new debt.~~

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4. **Capital Expenditure** – means expenditures incurred to acquire, develop, renovate or replace capital assets as defined by Public Sector Accounting Board section 3150 and FIN-001-027 Tangible Capital Assets Financial Reporting Policy.

~~5. **Debt Limit** refers to the Province of Alberta Debt Limit regulation and guideline that provides that a municipality's total debt outstanding cannot exceed 1.5 times its annual operating revenue.~~

5. **County Revenues** – means annual revenues as published in the last audited financial statements of the County prior to the time of calculation, to include revenues from taxes, Utilities, user fees, departmental and corporate programs, developer and customer contributions, and Boards and Authorities as calculated under the Debt Limit Regulations A.R. 222/2000, as amended.

~~6. **Developer Levy Supported Debt** refers to debt incurred for capital projects that are related to new development (i.e. arterial roadways, utility infrastructure (major water transmission mains and sewer trunks). The debt incurred is repaid, together with interest, from current and future developer levies.~~

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6. **Debt** – means borrowing as defined under MGA section 241(a.1). In the case of the County, this is usually in the form of a debenture varying in Debt Terms. Other forms of Debt include but are not limited to; leases of capital property as defined under MGA section 241(c); other long-term financial commitments; Public Private Partnerships (PPP) Community Revitalization Levy financing; and loans and loan guarantees issued under sections 264 & 265 of the MGA.

~~7. **Debt Repayment** refers to the regular and/or special repayment of debt principal that has been incurred to finance capital projects.~~

7. **Debt Limit** – means the Debt Limit for the County, in respect of the County's total Debt and Debt Service, as determined in accordance with the MGA Debt Limit Regulation Alberta Regulation 255/2000, as amended.

~~8. **Internal Borrowing** refers to borrowing from County reserves (generally the Capital Debt Reduction capital reserve) to finance a capital project. When an internal borrowing occurs, it is planned that the reserve is repaid the principal amount borrowed plus interest.~~

8. **Debt Servicing** – means annual required Debt Repayments for principal plus the interest amount to be paid on the outstanding debt.

~~9. **Local Improvement Supported Debt** refers to debt incurred to support capital improvements that benefit specific properties pursuant to an approved local improvement plan. Local improvement tax levies on the benefiting properties will be sufficient to provide for the annual debt servicing requirements and the orderly repayment of the debt.~~

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9. **Debt Repayment** – means the regular repayment of Debt principal that has been incurred to finance capital projects.

~~10. **Long-term Debt** refers to borrowings from third parties scheduled for repayment (i.e. generally amortized over a period of five or more years).~~

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10. **Debt Term** – the period of time during which Debt payments are made. At the end of the Debt Term, the Debt is paid in full.

~~11. **Other Supported Debt** refers to non-municipal tax supported debt that will be repaid, together with interest, from user fees and/or external sources. External sources include public library tax levies and Seniors Management Services tax levies.~~

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11. **Flexibility** – is the ability of the County to issue new Debt in response to emerging financing needs.

~~12. **Municipal Tax Supported Debt** refers to debt incurred that will be repaid, together with interest, through municipal property tax levies. The establishment of annual property tax rates will be sufficient to provide for the annual debt servicing requirements and the orderly repayment of the debt.~~

12. **Intergenerational Equity** - in the economic context, this refers to distributing the costs associated with capital growth across the generations which will be enjoying the benefits of the capital assets built today.

~~13. **Utility Rate Supported Debt** refers to debt incurred for utility operations capital projects that will be repaid, together with interest, by a portion of the annual utility rates charged utility operations customers.~~

13. **Long-Term Debt** – Debt with a term greater than five years, as defined under MGA section 258(1).

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14. **Reserves** – means money that has been specifically set aside by Council to finance future expenditures.

15. **Short-Term Debt** – Debt with a term of five years or less, as defined under MGA section 257(1).

16. **Sustainable** – means meeting the needs of the present without compromising the ability of future generations to meet their own needs.

17. Utilities – are self-funded operations providing a service to its customers, including a return on investment, at rates regulated by Council. These Utilities include Community Energy, Water, Wastewater and Solid Waste.

Guidelines

1. **Use of Debt**
   a. Strathcona County will only incur and carry long-term ~~d~~Debt when it is consistent with the Strategic Plan direction and objectives to support priority capital projects pursuant to approved capital budgets.
   b. Long-term Debt will not be incurred for operating purposes. ~~The County may, from time to time, incur short-term debt (i.e. bank line of credit funding) to bridge short-term cash flow requirements (the primary source of bridging is reserves).~~
   c. ~~Generally, l~~Long-term ~~d~~Debt will typically ~~only~~ be incurred after ~~all other funding sources have been explored.~~ the actual Capital Expenditure.
   d. The County may, from time to time, incur Short-Term Debt (e.g. bank line of credit financing) to bridge short-term cash flow requirements (note that the primary source of bridging is Reserves).

~~2. Total debt outstanding shall not exceed the Province of Alberta Debt Limit regulations and guidelines. These provide that a municipality's total debt outstanding cannot exceed 1.5 times its annual operating revenue.~~

2. **Debt Approval**
   a. New capital projects to be approved for Debt financing will proceed through the business planning and budget process
   b. All issuance of Debt requires an authorized bylaw. The Authorized Borrowing Bylaw must be in place prior to undertaking capital activities funded by external Debt sources.

~~3. Total annual debt service payments shall not exceed the Province of Alberta Debt Service Limit regulations and guidelines. These provide that a municipality's total annual debt servicing payments cannot exceed 25% of its annual operating revenue.~~

3. **Debt Planning & Management**
   a. The tolerance or capacity to absorb and manage new Debt will be analyzed as part of the annual capital budgeting process to determine the necessity for and viability of the capital project and identify the revenue stream for the repayment.

   b. Intergenerational Equity is considered when determining capital projects that will proceed for Debt approval.

   c. Annual projected utility operations Debt service payments are supported by projected utility rates as determined by the utility rate model approach. The potential impact to future utility rates must be considered and acknowledged in advance of incurring new utility Debt.

~~4. The amortization period of new debt incurred shall not exceed the estimated life of the capital project being financed. The amortization period shall generally not exceed 15 years unless the estimated useful life of the capital project and the projected cash flow of the payment support demonstrates a term of 20 or 25 years to be more appropriate and beneficial.~~

4. **Debt Limits**
   a. Total Debt outstanding
      - Shall not exceed 80% of the Province of Alberta Debt Limit regulations as calculated under the Debt Limit Regulation A.R. 255/2000, as amended.

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- o These regulations indicate that a municipality's total Debt outstanding cannot exceed 1.5 times its annual operating revenue.

b. Total annual Debt service payments
- o Shall not exceed 80% of the Province of Alberta Debt Service Limit regulations as calculated under the Debt Limit Regulation A.R. 255/2000, as amended.
- o These regulations indicate that a municipality's total annual Debt Servicing payments cannot exceed 25% of its annual operating revenue.

c. The total Debt outstanding and total annual Debt service payments will be applied to the Utility User Rate Debt independently. Prior to the Utility User Rate Debt exceeding the MGA debt limits, administration will report to Council with recommendations on the current and projected Utility debt position.

~~5. When sufficient funds are available, the County may internally borrow from its reserve funds (i.e. debt avoidance) to provide for the financing of capital projects. Reserves will be repaid with interest (generally over a period of five (5) years or less), with the interest rate equivalent to the average current rate of return the County receives on the investment of surplus funds.~~

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5. Debt Categories

a. To support Debt planning, management and reporting, Debt is categorized into three groups based on the nature of the Capital Expenditure and the financing source for Debt Servicing as follows:
1. Tax-Supported Debt
   - o Issued for Capital Expenditures related to tax supported operations.
   - o This Debt will be repaid, including interest, using tax-supported revenues such as property and business taxes, non-utility user fees, fines, permits and investment income.
2. Utility User-Rate Debt
   - o Issued for Capital Expenditures related to Utilities.
   - o This Debt will be repaid, including interest, using Utility user rates.
3. Non Tax-Supported Debt
   - o Issued to fund Capital Expenditures by activities or programs which are self-funded, including but not limited to:
   - o Local Improvement Supported Debt
     - Issued for capital improvements that benefit specific properties pursuant to an approved Local Improvement plan.
     - This Debt will be repaid, including interest, from Local improvement tax levies on the benefiting properties
   - o Developer Levy Supported Debt
     - Issued for Capital Expenditures that are related to new development such as arterial roadways or utility infrastructure.
     - This Debt will be repaid, including interest, from current and future developer levies.

~~6. When the incurrence of long-term debt is deemed to be an appropriate method to finance capital projects, then Alberta Capital Finance Authority (ACFA) will be initially considered. ACFA long-term interest rates are generally 0.50% to 0.75% more favourable than conventional bank financing. Where it is more attractive and advantageous, a long-term financing arrangement with another acceptable lender will be considered.~~

6. Debt Terms

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a. The Debt Term shall not exceed the estimated life of the capital project being financed.

b. The following elements should be considered when establishing the Debt Term:
- o cost minimization,
- o availability of Debt Servicing funding,
- o intergenerational equity,

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- o capital life cycle implications,
- o sustainability, and
- o financial flexibility.

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~~7. The County will take advantage of opportunities to retire outstanding debt early if it appears to be financially beneficial to do so. High interest, municipal tax supported debt will be given priority consideration for debt prepayment.~~

7. Debt Issuance

a. When the incurrence of Long-Term Debt is deemed to be an appropriate method to finance capital projects, then ACFA will be initially considered.

b. Where it is more attractive and advantageous, a long term financing arrangement with another acceptable lender will be considered.

~~8. The Debt Management Plan will establish a tolerance or capacity to absorb and manage new debt.~~

8. Debt Structure

a. Alternative Debt Repayment structures can be utilized to issue Debt. Examples are:
- o Level Debt Service (Blended Amortization) – fixed payment over the life of the term with a blend of principal and interest in the amount
- o Fixed principal – payment declines over time as principal repayment amount is fixed and interest is added based on the outstanding balance
- o Bullet – fixed interest only payments until the end of the term when the principal and final interest payment are made
- o Fixed and variable rates – a unique repayment schedule

~~9. Year-end municipal tax supported debt outstanding shall not exceed a ceiling of 100% of the debt limit. The ceiling percentage guideline will have the effect of limiting new municipal tax supported debt that can be incurred in any given year.~~

9. Internal Financing

a. As per FIN-001-024 Financial Reserves Policy, reserve description R13 – Internal Financing, the County may use the Internal Financing Reserve as a source of funds for the internal financing of operating and capital projects as approved by Council.

b. Internal loan repayments will be made from user fees, utility user rates, municipal taxes, or other identified sources through the annual operating budget.

c. Internal loans from the Internal Financing reserve will be 5 year terms unless otherwise identified in the business planning and budget process.

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~~10. Year-end total debt outstanding shall not exceed a ceiling of 100% of the debt limit. The ceiling percentage guideline will have the effect of limiting new total debt that can be incurred in any given year.~~

10. Reporting

a. Regular reporting on the County's utilization of Debt will occur through management reporting.

b. The County's Debt Limits, total Debt outstanding, and total annual Debt service payments will be reported in the Annual Consolidated Financial Statements.

c. Long-term projections for outstanding Debt will be provided through the annual budget process.

~~11. The established ceiling percentage guidelines will be reviewed annually during the budget process to take advantage of opportunities to protect, increase or reduce the ceiling and, therefore, the capacity.~~

~~12. Annual non-municipal tax supported (i.e. other supported debt such as local improvement levy, developer levy, user fee, and other external) debt service payments are supported by confirmed sources of revenues prior to the incurrence of new debt. In each case where the incurrence of non- municipal tax supported debt is considered, a business case will be prepared~~

~~to confirm the necessity for and viability of the capital project and the financial plan in place identifies the distinct revenue stream that will provide for the repayment.~~

~~13. Annual projected utility operations debt service payments are supported by projected utility rates as determined by the utility rate model approach. The impact to future utility rates is known and acknowledged in advance of new utility debt incurred.~~

~~14. This Debt Management Policy will be subject to annual review during the annual business plan and budget process.~~

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Policy Record

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Enclosure 2