

Subject: Cash Management and Debt Policy Updated

Recommendation:

BE IT RESOLVED THAT Council receive Report #2024-0223 Cash Management and Debt Policy Updated, for information;

AND THAT Council approve the updated S400-07 Capital Financing and Debt Management Policy, as appended.

Background:

The current S400-07 Capital Financing and Debt Management Policy (Debt Policy) was approved by Council on January 13, 2020.

There is a requirement that this policy shall be presented to Council for review (and update if required) every four years, or more frequently as deemed necessary by Council, the Chief Administrative Officer, or the Treasurer. Appendix 1 has the updated policy.

Capital assets can be financed through a variety of funding sources such as Reserve Funds, Grants, Debt, or Development Charges.

The objective of the Town of Pelham's Debt management strategy is twofold:

1. Ensure any future financing needs are met (sustainability)
2. Adapt and respond to any unanticipated capital of operating funding requirements should they arise (flexibility)

Municipalities have provincial limits on the amount of debt they can hold. Provincial limits on municipal debt are based on a maximum percentage of "own-source revenues" that may be used to service debt costs (interest and principal payments) on an annual basis. In Ontario, municipalities may incur long-term debt for municipal infrastructure as long as annual debt payments do not exceed 25% of "own-source" revenues. This is referred to as the Annual Repayment Limit (ARL). The ARL is essentially the maximum amount that a municipality can pay in principal

and interest payments in the year for new long-term debt (and in annual payments for other financial commitments).

The establishment of the Internal Debt Limit that is in the Debt Policy (section 4.4) was determined after the Town recognized the importance of protecting and preserving capital while maintaining solvency and liquidity to meet ongoing financial requirements. To ensure long-term financial sustainability and flexibility, the Town will strive to implement an Internal Debt Limit which is lower than the ARL. This was established after reviewing the best practices of other municipalities in the province. To maintain financial sustainability, many Ontario municipalities set their Internal Debt Limit lower than the ARL. The goal of the approved Debt Policy was to set the Internal Debt Limit to 10% of Own-Source Revenues by 2030. Since the Town was well above the 10% limit at the time when the debt policy was approved, a phased-in approach was established to achieve the target internal limit. The phase-in targets as approved in the updated debt policy are as follows:

- a) From 2025 to 2029: Annual Debt Financing Charges shall not exceed 12% of Own-Source Revenues.
- b) From 2030 onward: Annual Debt Financing Charges shall not exceed 10% of Own-Source Revenues.
- c) The Town will strive toward the target that a maximum of 50% of the anticipated obligatory Reserve Fund collections will be spent on Debt so as to maintain a minimum cash balance in the Reserve Fund.
- d) Annual Debt Financing Charges for non-tax supported Debentures, such as water and wastewater rate supported Debt, shall not exceed 10% of own-source rate-supported revenues.

Analysis:

Financial sustainability is one of the key objectives of the Town's strategic plan. The existing debt policy was established almost 5 years ago, and the capital financing needs and assumptions have drastically changed over the last 5 years. There several input variables that go into determining an appropriate level of debt the Town should have:

1. Annual Repayment Limit (ARL) – The province of Ontario mandates that municipalities' annual debt servicing cost cannot exceed more than 25% of their own source revenues. The ARL is calculated on a cumulative basis; therefore, any existing debt reduces the room available for future borrowing.

2. Capital Expenditures – Debt is most often used to fund capital expenditures when the Town doesn't have sufficient funding available in reserves and other funding sources such as grants, external contributions, donations etc. have been exhausted. Having a robust long range capital forecast allows the Town to forecast when cash will be needed for major capital expenditures, which helps shape the debt forecast.
3. Sustainability of Reserves – A long range reserve forecast is used to determine the level of capital expenditures that is anticipated to be funded from reserves. Any capital expenditures that cannot be funded from reserves will require other funding sources such a debt (after exhausting all other sources such as grants, external funding contributions, etc.). Having a sustainable contribution to capital reserves from the operating budget provides some predictability on future reserve balances and the need for debt.
4. Existing Debt – It is important to review the existing debt load resulting from past capital expenditure. Higher existing debt load limits the Town on future borrowing needs without significantly impacting taxpayers.
5. Affordability – The affordability factor seems an obvious consideration, however it can easily be overlooked when confused with the ARL. Although the province sets the ARL at 25%, many municipalities cannot afford to reach the ARL limit without having significant tax rate increases to service this debt. This is especially true for smaller municipalities like Pelham where a \$1 million debt issue would add roughly 0.5% to the tax levy (example based on a 15-year debt issue at 5%).

Debt Repayment Reserve

The Town established a debt repayment reserve in December 2023 with Council approval. The purpose of the reserve is to offset operating budget increases due to issuance of new debt for major rehabilitation projects (i.e. fire station, PW facility etc.). The Debt Repayment Reserve is funded from existing expiring debt payments which are already built into the operating budget.

The draft 2025 10-year capital plan includes two major facility rehabilitations in the next 5 years; Fire Station 1 in 2026 and a Public Works Facility in 2028. The rehabilitation of these 2 major facilities is anticipated to cost over \$13 million. It should also be noted that no monies have been identified with respect to the library renovation project. Pelham's existing reserves will not be able to fund these rehabilitation costs and debt will likely have to be issued for these projects.

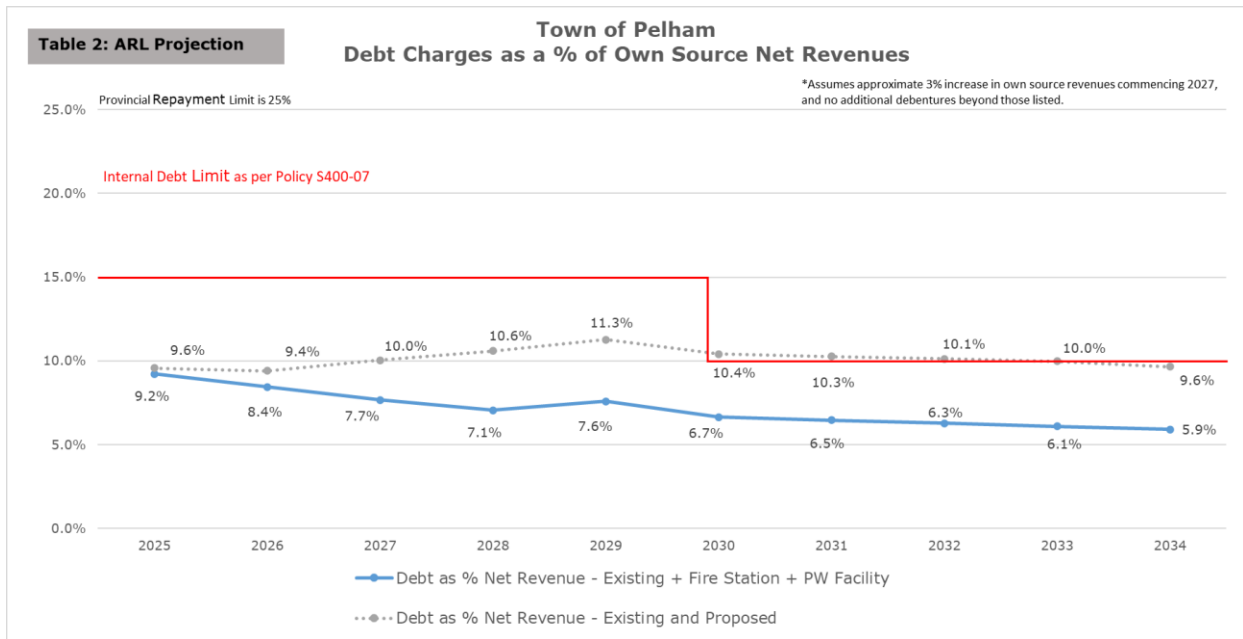
The forecast of the debt repayment reserve indicates that there will be sufficient funds to cover the annual debt servicing cost for both of these major facilities rehabilitation projects. This provides some flexibility to the Town as without the offset from this reserve, the tax levy would require substantial future increases to manage the new debt from these projects. Table 1 below presents the debt repayment reserve forecast:

Table 1: Debt Repayment Reserve Fund										
	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Opening Balance	-	150,347	503,989	743,086	931,615	1,075,528	936,666	1,008,284	1,079,903	1,151,521
Transfer to Reserve - Note 1										
Bridge Loan	150,347	150,347	150,347	150,347	150,347	150,347	150,347	150,347	150,347	150,347
Roads - Pelham St (310)		102,264	102,264	102,264	102,264	102,264	102,264	102,264	102,264	102,264
Fire Station #2		101,031	101,031	101,031	101,031	101,031	101,031	101,031	101,031	101,031
RDS - Port Robinson		27,028	27,028	27,028	27,028	27,028	27,028	27,028	27,028	27,028
Fire Station #3			153,650	153,650	153,650	153,650	153,650	153,650	153,650	153,650
RDS - Fenwick Downtown Rev				175,816	175,816	175,816	175,816	175,816	175,816	175,816
RDS - East Fonthill Roads Constr				68,836	68,836	68,836	68,836	68,836	68,836	68,836
REC - Predevelopment for New Facility							111,648	111,648	111,648	111,648
RDS - East Fonthill Roads (Wellspring/Shaw)							122,405	122,405	122,405	122,405
RDS - Summersides: East to Rice							195,831	195,831	195,831	195,831
RDS - Summersides: Station to Wellspring							18,756	18,756	18,756	18,756
Total Additions	150,347	353,642	534,319	778,971	778,971	778,971	1,227,611	1,227,611	1,227,611	1,227,611
Transfer From Reserve - Note 2										
Fire Station 1 - New Debt			295,222	590,443	590,443	590,443	590,443	590,443	590,443	590,443
PW Facility - Property Acquisition					44,615	89,230	89,230	89,230	89,230	89,230
PW Facility - Construction						238,160	476,320	476,320	476,320	476,320
Total Subtractions	-	-	295,222	590,443	635,058	917,833	1,155,993	1,155,993	1,155,993	1,155,993
Ending Balance	150,347	503,989	743,086	931,615	1,075,528	936,666	1,008,284	1,079,903	1,151,521	1,223,139

Annual Repayment Limit (ARL)

The Town of Pelham's 2024 Annual Repayment Limit Statement shows the Town is using \$2.9 million, or 10.77% of Net Revenues to service its debt. This is down from 13.5% in 2023. Pelham's 2025 ARL is projected to be \$2.8 million or 9.57%. The improvement in the Town's ARL has been a result of increasing own-source revenues and the absence of new debt issues in the last few years.

At the time of writing this report, staff was finalizing the 2025 Draft Capital budget. Table 2 below provides a projection of the ARL over the next 10 years based on the capital expenditures currently included in the 2025 10-year capital plan.



Based on the current 10-year capital forecast, the ARL would not go above 11.3% in the next 10 years. The blue line represents the Town’s existing debt as well as new debt for 2 major facilities (Fire Station 1 and PW Facility, and for this purpose ignoring the library renovation project) that will be offset by the debt repayment reserve contributions. The dotted line represents the forecasted debt currently proposed in the draft 2025 10 year-capital plan.

It is important to note that when staff reviewed the first draft of the 2025 10-year capital plan, the major expenditures from this forecast would push the ARL to 21.8% at its peak in 2031. Under this scenario, the Town would be non-compliant with its internal debt policy and there would be serious affordability concerns related to the high debt servicing cost. Staff have completed a detailed review of the 10-year capital forecast over the past several months to get it to a more affordable and manageable place.

Comparison to Niagara Municipalities

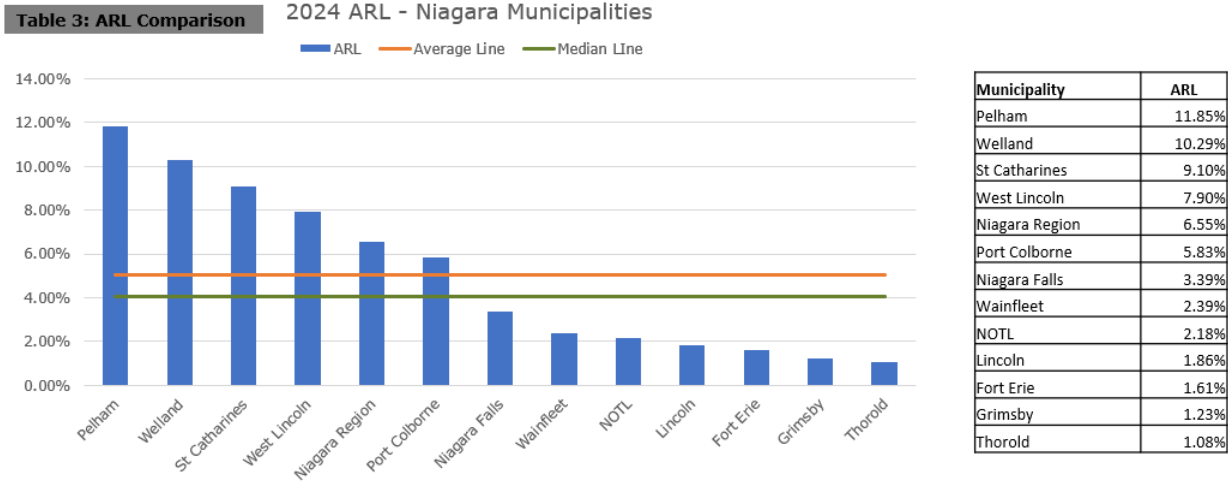
Niagara Region has been in discussion with Local Area Municipalities (LAMs) to enhance collective debt planning and adapt common strategies for capital financing. The Region issues the debt on behalf of LAMs and its currently facing several challenges regarding debt such as, high debt burden for Niagara Region, potential risk to Niagara Region’s credit rating, Infrastructure Ontario debt limit and Annual Repayment limit considerations.

In order to mitigate these risks, The Region is proposing some strategies such as moving to sustainable funding models for infrastructure replacement by ensuring

adequate funds are transferred to reserves each year and using collective debt planning by working with LAMs to smooth debt ask and maintain debt room for growth and strategic projects.

Table 3 below shows the comparison of Annual Repayment Limit for Niagara Municipalities.

Pelham continues to have the highest ARL in all of Niagara region, based on the most recent available data from Financial Information Return (FIR). In fact, Pelham’s ARL is more than twice the average (5.07%) and almost three times the median (4.03%) of the Niagara region municipalities. Absences of new debt issuances combined with increased in revenue has lowered the ARL over the last number of years. It is important to maintain this trajectory as the Town continues to pay off its large existing debt commitments.



Recommendations

Staff are recommending the following changes to the debt policy:

1. Phased in internal debt limit from 2025-2030 is recommended to be lowered to 12% from 15%. Internal debt limit beyond 2030 is set at 10% (no change from existing policy)
2. It is recommended that the debt policy be updated to include the reference to the new Debt Repayment Reserve. This reference should briefly discuss the history, purpose, and funding source for the new debt repayment reserve.

On September 10, 2024 the Pelham Finance and Audit Committee reviewed and supported the updated policy.

Financial Considerations:

Updating the debt policy does not have a direct financial impact. However, the debt policy limit guides many important decisions in financing of capital projects as outlined throughout this report.

Alternatives Reviewed:

The alternative is to not reduce the internal debt limit currently and maintain existing policy limit of 15% until 2029 and 10% from 2030 onwards. This alternative is not recommended due to the reasons outlined above.

Strategic Plan Relationship: Financial Health

The Financial Health of the Town is a key strategic objective and ensuring that the Town's finances have a healthy balance of debt, reserves, grants, and development charges to finance capital projects.

Consultation:

Pelham Finance and Audit Committee

Other Pertinent Reports/Attachments:

Appendix 1: Updated S400-07 Capital Financing and Debt Management Policy

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