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Council Policy

Debt Policy

ESTABLISHED: September 17, 2018

Contact Department: Financial Services

Guiding Principle

This policy aligns with the principles laid out in the Council adopted Principles & Strategies for Financial Strength & Stability Document.

Debt Limits

- Legal Limits: All borrowing, debt, or liabilities as defined by PSAS must adhere to legislative requirements;
- Financial Limits: Debt must balance sustainability and flexibility.

Debt Structure

- Public Policy Limits: Debt is one component of a capital financing structure and must be integrated into realistic long term financial plans;
- Interfund Borrowing: Internal financing sources used to meet short-term cash flow and borrowing needs.

Purpose

The purpose of the policy is to ensure that debt financing is used strategically to maintain the City's financial strength and stability. Other policy objectives are to provide appropriate guidance for the use of debt to support the goal of providing adequate infrastructure, services and resources to meet the community requirements, and to ensure the financial sustainability of the City. The policy sets out guidelines for using debt along with the ongoing administration requirements.

Benefits of a debt policy:

- It is a fundamental component of a well-developed and credible financial management strategy,
- Supports financial stability and discipline,
- Provides guidance to staff, Council and the public on what the limitations on debt financing are.

Application

Financial policies are intended to provide direction for the City in financial decision making and to facilitate appropriate financial capacity for present and future needs. The creation, use and management of debt in a formal policy is a best practice that will set the direction and define objectives that will provide the City greater financial stability and prosperity.

Policy Statements

Legal Limits: All borrowing, debt, or liabilities must adhere to legislative requirements

Debt financing will only be undertaken in compliance with the relevant sections of the Community Charter and related regulations. Specifically:

i. The City will not incur a liability if that causes the **annual cost of servicing the aggregate liabilities to exceed 25% of the annual calculation revenue of the City for the previous year** (CC Section 174 and regulation 254/2004).

The different types of debt are summarized in Appendix 1.

Financial Limits: Debt must balance sustainability and flexibility

Debt must be affordable and sustainable while ensuring long-term financial flexibility. Sources of funding for debt repayment must be identified prior to borrowing approval and be sufficient to cover annual repayment while still maintaining some flexibility in that area (i.e. DCC or Airport AIF repayment).

Internal municipal debt limits based on debt servicing costs are set at:

- **15% of City own source revenues, and**
- **8% of annual tax levy revenues for tax supported debt**.

Tracking and reporting on debt levels is an important requirement that is included in the annual Budget document and the Annual Report. The following key indicators will be monitored to ensure long-term financial sustainability:

<u>Budgetary impact of debt</u>

The City's ability to maintain service levels from year to year will be monitored with the following ratio.

- **tax-paid debt charges as a percentage of annual tax levy revenue**

<u>Community ability to support debt</u>

The community's ability to support further indebtedness will be monitored with the following ratios.

- **debt per capita**
- **debt to taxable property value**

Several items need to be considered in regards to the debt term; cost minimization, availability of servicing funds, fair distribution of costs between periods, as well as capital life cycle implications. The cost to refinance existing debt after the first 10 years should be reviewed to determine economic impacts and feasibility of early repayment.

The timing, type and term of financing for each capital asset will be considered with a view to minimize the City's overall long-term cost of financing. Factors to consider will include the current versus future expected interest rates, the availability of related reserve monies, the life of the asset, the expected revenues or cost savings from the capital asset and the costs related to the financing of the project.

Financial flexibility should be emphasized for self-funded cost centres to ensure their ability to respond to emerging opportunities. The relationship between self- and taxation-funded debt will be monitored with the following ratio:

- **self-funded debt as a percentage of total debt**

Public Policy Limits: Debt is one component of a capital financing structure and must be integrated into realistic long term financial plans

Debt is to be managed in a manner consistent with the guiding principles and long-term planning objectives of the City. New debt must align with capital plans and strategies to support the City's long-term goals.

Decisions about the use of debt must consider all alternative capital financing sources. Long term debt will be considered for capital expenditures that are included in the City's approved 10 Year Capital Plan and are for:

- Large projects with long term benefits (tax supported debt projects benefit the community at large),
- Growth or emerging need related projects. These projects may be recoverable through the Development Cost Charge program as planned, through user fees, or through taxes or utility revenue,
- Major rehabilitation of an existing asset as a short-term strategy to eliminate a significant shortfall

Long term capital plans must include a section detailing the anticipated borrowing and the annual repayment impacts of all debt.

Matching the term of the capital financing to the useful life of the asset allocates the cost to the users of the asset and contributes to intergenerational equity. However, there is a 30 year limit to long term borrowing and to protect against obsolescence or assets not achieving their expected useful life, it is preferred for the debt term to be less than the probable life of the asset (75%), if it is affordable.

Internal financing sources used to meet short-term cash flow needs

The City of Kelowna may borrow funds from its own general reserves with repayment of principal and interest in order to finance capital projects. This may relate to projects that are pending debenture issues and require interim financing or to projects that make use of reserve funds not required in the near future. There is no statutory limit to this borrowing as it is offset by existing reserve balances. It is an effective financing tool, especially when investment interest is low. Use of statutory reserves is more restricted and is not designed for lending from one reserve fund to another.

Construction financing methods will be considered using internal financing or short-term MFA borrowing in advance of long term funding. The optimal use of City cash should be considered with each borrowing request.

The type of debt should be considered in each case to limit risk. Aside from MFA borrowing there should be a determination of the best option for the particular case; a liability agreement, lease financing, short term borrowing or internal financing

RESPONSIBILITY & AUTHORITY

Council will approve:

i. The policy and any updates and amendments to the policy;
ii. The issuance of new debt through the Long Term Capital Plan, the annual budget process and the approval of required bylaws;
iii. The annual review report on the City's debt status.

The Chief Financial Officer will be responsible for:

iv. Reviewing the principles and policy statements and recommending any updates and amendments to the policy;
v. The overall responsibility for the capital financing program of the City and ensuring the Long Term Capital Plan details the borrowing requirements and the impacts of debt repayment;
vi. Managing, monitoring and reporting the debt program;
vii. Conducting an annual review of the debt status and reporting the results through to Council.
viii. Requesting the use of debt funding of a capital project through the Long Term Capital Plan;
ix. Requesting debt funding to be used for a particular budget request consistent with the Long Term Capital Plan and in coordination with Financial Services.

APPENDIX

Types of Debt

Types of Debt – there are various types of liabilities that are available under legislation and this policy to obtain, through borrowing, funds necessary to acquire assets.

i. Long Term Debenture

Long Term Debenture borrowing involves the repayment of both principal and interest over a period not to exceed 30 years. The City of Kelowna has undertaken to limit the term on long term borrowing to 20 years wherever possible. Debenture borrowing for most long-term needs requires the assent of electors through an alternative approval process and/or the passing of a referendum.

ii. Liabilities Beyond the Current Year

Under an agreement, Council may incur a liability payable after the current year as long as it is not a debenture debt and the liability does not exceed the life expectancy of the activity. If the agreement is for longer than 5 years, or contains a right of renewal that could exceed 5 years, an alternative approval process must be provided. This borrowing method is used by the City of Kelowna to secure the purchase of land from a vendor.

iii. Short Term Borrowing

Short Term Borrowing is used to undertake minor capital works programs and must be repaid over a period not to exceed 5 years. The City of Kelowna's short term borrowing legal capacity is based on $50 per capita. The City uses this borrowing method for the upgrade or construction of facilities and the purchase and development of parks.

iv. Revenue Anticipation Borrowing

Operating loans may be required to meet current expenditures pending receipt of taxation revenue. This most often occurs in the few months prior to the annual July due date for tax payment and is repaid once tax revenue is received. To transact operating loans, a Revenue Anticipation Borrowing By-Law must be approved by Council and is limited to 75% of taxes due in the preceding year.

v. Loan Guarantees & Commitments

A loan guarantee is a promise by the guarantor to assume the debt obligation of a borrower if that borrower defaults. The City of Kelowna can undertake a loan guarantee agreement to facilitate the growth of community-focused organizations.

Glossary

The following terms are used in this policy and are defined as follows:

Affordability	The ability to pay for debt servicing costs and life cycle expenditures for the underlying asset. The relation of those costs relative to City revenues is the measure of affordable debt.
Annual Calculation Revenue	The total revenue of the City for the year, excluding revenues from the following sources: taxes collected for another public body, unconditional grants, revenue received under an agreement and payments in place of taxes that are made by a public authority.
Capital Expenditure	Expenditures incurred to acquire, develop, renovate or replace capital assets as defined by Public Sector Accounting Standard section 3150.
Capital Financing	Term for the financing of capital assets acquired through a variety of sources but for this policy it is assumed to mean the use of debt.
Debenture	A formal written obligation to repay specific sums on certain dates. Debentures issued by a municipality are unsecured and are backed by the good faith and credit of the municipality.
Debt	An obligation for the repayment of money. Long term debt normally consists of debentures; short term debt may include notes or loans from financial institutions or from MFA, and may also include purchase agreements or loans from reserves or reserve funds.
Debt Servicing	The annual required debt repayments including principal and interest.
MFA – Municipal Finance Authority	A collective structure operating under the governance of a Board of Members appointed by the Regional Districts and independent of the Province of BC. The Authority was established in 1970, under its own act, to pool the borrowing and investment needs of BC communities.
Own source revenues	Revenue derived from internally generated programs and services (user fees, license fees, sale of service revenues, etc.) excluding revenue from self-funded cost centres.
Self-Funded	A cost centre or fund that does not rely on taxation for funding (airport, natural gas, water, and wastewater)

Amendments

R878/18/09/17 – Policy Approved