



THE CORPORATION OF THE  
*Township Of Pelee*

CAPITAL FINANCING AND DEBT  
POLICY

Effective: August 22, 2014

As Authorized by By-law No. 25 of 2014

**SECTION:** FINANCE & ACCOUNTING

**SUBJECT:** CAPITAL FINANCING AND DEBT

**POLICY STATEMENT:**

It is the policy of the Corporation of the Township of Pelee to govern the use and administration of capital financing and debt.

**PURPOSE:**

This policy ensures that all statutory requirements with respect to incurring debt for capital purposes and the issuance of debentures and prescribed financial instruments for/or in relation to the debt are complied with.

**APPLICATION :**

Any debt obligation or financing lease entered into by the Township, as well as, those employees responsible for the control, administration or management of capital financing and debt issuance activities.

**DEFINITIONS:**

**Long-Term Debt:** Any debt for which the repayment of any portion of the principal is due beyond one year.

**Amortizing Debentures:** Debentures for which the total annual payment (principal and interest) is approximately equal throughout the life of the debenture issue.

**Instalment (Serial) Debentures:** Debentures of which a portion of the principal matures each year throughout the life of the debenture issue.

**Capital Financing:** A generic term for the financing of capital assets using debt instruments including finance leases.

**Township:** Refers to The Corporation of the Township of Pelee.

**Construction Financing:** A form of debt financing in which the issuer does not pay any principal and/or interest for a period up to 5 years during the

construction or rehabilitation of a municipal facility from which a revenue stream is expected to be generated.

**Debenture:** A formal written obligation to repay specific sums on certain dates. Debentures are direct, unsecured and unsubordinated obligations of a municipality and must rank equally in respect of payment of principal and interest with all other debentures of a municipality.

**Debt and Financial Obligation Limit:** A calculation provided annually to a municipality by the Ministry of Municipal Affairs and Housing that determines the maximum amount of new annual debt servicing costs that a municipality can undertake or guarantee without seeking the approval of the Ontario Municipal Board.

**Debt:** Any obligation for the payment of money. For Ontario municipalities, debt would normally consist of debentures as well as either notes or cash loans from financial institutions but could also include loans from reserves. Notes and debentures issued by a municipality to Ontario Infrastructure Lands Corporation (Infrastructure Ontario) considered as debt.

**Financing Lease:** A lease allowing for the provision of municipal capital facilities if the lease may or will require payment by the municipality beyond the current term of Council.

**Fiscal Agents:** An individual or group of investment bankers appointed by Council to assist in the pricing, issuance timing, and sale of new debentures.

**Long-Term Bank Loan:** Long-term debt financing provided by a bank or a syndicate (group) of banks.

**OILC (Ontario Infrastructure Lands Corporation):** Infrastructure Ontario's Loan Program provides long-term financing to eligible public sector clients to help renew infrastructure and deliver value to customers and residents.

**Project Financing:** Financing in which principal and interest payments are structured so as to more closely match the revenues or cost savings of a specific project. Also includes financing for which the lender, in the case of default, would have no or limited recourse to the borrower beyond the assets acquired with the proceeds of the financing.

**Short-Term Debt:** Any debt for which the repayment of the entire principal is due within one year.

**DESCRIPTION:**

**Philosophy**

Township Council may, where deemed in the best interest of its taxpayers, approve the issuance of debt instruments for its own purposes.

“**Best interest**” will be consistent with the following key financial principle with respect to capital financing and debt practices:

“Capital financing and debenture and prescribed debt instrument issuance practices will be responsive and fair to the needs of both current and future taxpayers and will be reflective of the underlying life cycle and the nature of the expenditure.”

This philosophy shall be met through the objectives outlined below:

**Capital Financing and Debt Objectives**

The primary objectives, in priority order, shall be:

- Adhere to statutory requirements;
- Ensure long term financial flexibility;
- Limit financial risk exposure;
- Minimize long-term cost of financing;
- Match the term of the capital financing to the useful life of the related asset;
- and,
- Maintain a level of annual debt service cost that do not exceed 10% of total operating revenues

**a) Adhere to Statutory Requirements**

Capital financing may only be undertaken when in compliance with the relevant sections of the applicable legislation including the Municipal Act, 2001 (the “Act”), (the Drainage Act, the Planning Act, the Conservation Authorities Act, the Ontario Municipal Board Act,) and related regulations Local Improvement Act – repealed January 1, 2003, replaced by O. Reg. 119/03 (see s. 474.10 of the Municipal Act, 2001.). Requirements include but are not limited to the following:

- i) The term of temporary or short-term debt for operating purposes will not exceed the current fiscal year;
- ii) The term of the capital financing shall not exceed the lesser of 40 years or the useful life of the underlying asset;
- iii) Long-term debt will only be issued for capital projects;
- iv) The total financing charges after issuance of the proposed debt will not exceed the Debt and Financial Obligation Limit for the municipality (as issued by the Ministry of Municipal Affairs and Housing and updated by the Treasurer, as required) responsible for repaying the debt, unless otherwise approved by the Ontario Municipal Board;
- v) Prior to authorizing a financing lease, a report will be prepared assessing the costs as well as financial and other risks associated with the proposed lease with other methods of financing;
- vi) Prior to passing a debenture by-law under clause 408(4)(d) of the Act (authorizing the issuance of "construction financing debentures") which provides that instalments of principal or interest, or both, are not payable during the period of construction of an undertaking, Council will adopt a statement of policies and goals related to construction financing and in preparing such statement the Council shall consider the various items specified in O. Reg. 278/02 including all financial and other risks related to construction financing.

Furthermore, the awarding of any contract under this Policy, unless otherwise authorized by Council, will follow the procedures and authorities set out in the Township's Municipal Code of Conduct.

#### **b) Ensure Long-Term Financial Flexibility**

The capital financing program will be managed in a manner consistent with other long-term planning, financial and management objectives.

Prior to the implementation of any new capital financing, consideration will be given to its impact on future ratepayers as a means to achieve an appropriate balance between capital financing and other forms of funding.

To the extent practicable, replacement assets as well as regular and/or ongoing capital expenditures will be recovered on a "pay as you go" basis through rates, tax levy, user fees and/or reserve fund monies. However, where long-term financing is required, due consideration will be paid to all forms of financing including debentures, construction financing instruments and financing leases.

#### **c) Limit Financial Risk Exposure**

The capital financing program will be managed in a manner to limit, where practicable, financial risk exposure.

It will be the general practice to issue debt instruments that are denominated in Canadian dollars and where the interest rates will be fixed over their term.

**d) Minimize Long-Term Cost of Financing**

For each project or purpose for which long-term financing is requested, the timing, type and term of financing will be determined with a view to minimizing long-term cost.

Factors to be considered will include current versus future interest rates; the availability of related reserve fund monies; the pattern of anticipated revenues or costs savings attributable to the project or purpose; and, all costs related to the financing of the project whether by debenture, construction financing instruments or financing lease.

**e) Match Term of the Capital Financing To The Useful Life Of The Related Asset**

The maximum term over which a capital asset may be financed is 40 years. Council will approve, on recommendation of the Chief Administrative Officer/Clerk/Treasurer, the term of any capital financing. In no case may the term of financing exceed the anticipated useful life of the related asset.

**f) Maintain a level of annual debt service cost that do not exceed 10% of total operating revenues**

The Ministry of Municipal Affairs and Housing, as part of its annual Financial Indicator Report, recommends the ratio of annual debt service costs do not exceed 10% of the total annual operating revenues in any given year. At no time will long-term borrowing costs exceed this benchmark without the approval of council.

**Standard of Care**

An appropriate standard of care will be achieved in the following manner:

**a) Ethics and Conflicts of Interest**

Officers and employees involved in the capital financing process shall:

- i) Refrain from personal business activity that could conflict with the proper execution and management of the capital financing program, or that could impair their ability to make impartial decisions;
- ii) Disclose any material interests in financial institutions with which they conduct business;
- iii) Disclose any personal financial/investment positions that could be related to the performance of their capital financing duties; and
- iv) Not undertake personal financial transactions with the same individual with whom business is conducted on behalf of the Township.

**b) Delegation of Authority**

The Chief Administrative Officer/Clerk/Treasurer has overall responsibility for capital financing by the Township. The Deputy Clerk and Deputy Treasurer are responsible for the implementation of the capital financing program and the establishment of procedures consistent with this Policy. No person may engage in a capital financing activity except as provided under the terms of this Policy.

**c) Requirement for Outside Advice**

Township staff is expected to have sufficient knowledge to properly evaluate standard transactions. However, when in their opinion the appropriate level of knowledge does not exist for instances such as capital financing transactions that are unusually complicated or non-standard, or as otherwise directed, outside financial and/or legal advice will be obtained.

***Suitable and Authorized Financing Instruments***

The form of capital financing that meets the objectives listed above will in part be contingent upon its term and the type of asset financed.

**a) Short-Term – Under 1 Year:**

When financing operational needs for a period of less than one (1) year pending the receipt of taxes and other revenues, or to provide interim financing for capital assets pending long-term capital financing, any one or more of the following sources may be used:

- i) Reserves and reserve funds at the prevailing market interest rate;
- ii) Bank line of credit; and
- iii) Short-term promissory notes issued to chartered banks or to Infrastructure Ontario

**b) Long-Term – Greater than 1 Year:**

Financing of assets for a period of greater than one year may be from any of the following sources:

- i) Debentures, which may be comprised of any or all of the following:

- Instalment Debentures
- Sinking Fund Debentures
- Term Debentures
- Amortizing Debentures
- Authorized Debentures with a refinancing provision

Fixed rate debentures will be the standard form of long-term financing used by the Township.

- ii) Reserves and Reserve Funds

These may be used for both interim and medium-term financing if deemed cost effective or otherwise necessary. It is recognized that reserves and reserve funds are established for a designated purpose and must be available when that purpose requires.

iii) Long-Term Bank Loans

This may be used if deemed cost effective or otherwise necessary.

iv) Construction Financing

May be used for a period up to 5 years during the construction or rehabilitation of certain facilities for which a revenue stream will be generated. The Construction Financing provision may also be utilized to smooth out the long-term debt repayments and mitigate the impact on taxation through deferral of interest and/or principal. The following financial and other risks associated with this type of financing will be considered in relation to other forms of financing and where possible mitigated prior to use.

a) The financial risks include the following:

- Interest rates fall from the time the rate on the construction financing loan is established and completion of construction; and
- The final cost of construction could be materially less than initially forecasted and financed.

b) Other risks include:

- The construction project may not be able to proceed or is not completed for technical or other reasons.

v) Financing Lease

May be used when it provides material and measurable benefits compared with other forms of financing. Financing leases could include cross-border and rolling stock leases.

The following financial and other risks associated with this type of financing will be considered in relation to other forms of financing, and where possible mitigated prior to that use.

a) The financial risks include the following:

- The ability for lease payment amounts to vary if based on changes in an underlying benchmark debt instrument (generally

expressed as a particular Government of Canada Bond);

- The ability for lease payment to vary based on changes in the assumed residual values of the asset being leased; and

Uncertainty over leasing costs if contract needs to be extended or renewed.

b) Other risks include:

- The potential for the seizure and removal of leased equipment if the leasing company goes into default of its obligations to creditors, and its creditors have the legal right to seize assets of the leasing company.

vi) Financing through OILC (INFRASTRUCTURE ONTARIO)

This will be considered for prescribed infrastructure needs that qualify for the lower than prevailing market interest rate available through OILC (INFRASTRUCTURE ONTARIO).

### ***Sinking/Retirement Fund Debentures***

When sinking and/or retirement fund debentures are outstanding anytime during a calendar year, a Sinking Fund Committee will be established. The Committee will meet at least annually and will be chaired by the Chief Administrative Officer/Clerk/Treasurer and will have at least two additional members appointed by Council.

When setting the internal capitalization rate for new sinking/retirement fund debt at the time of its issue, the rate shall not exceed the lesser of the rate allowed in the Municipal Act, or the 5-year Government of Canada bond rate at time of issue.

### ***Reporting Requirements***

a) Annually, the Chief Administrative Officer/Clerk/Treasurer shall submit to Council a report or reports that:

i) Requests authority, if required, to finance certain capital items detailing for each item the type, amount, and the maximum term of financing;

ii) States the sum, if any, that must be raised for sinking fund purposes in that year;

iii) Lists any outstanding construction financing debentures including the following details:

- (a) A description of the estimated proportion of the total construction financing debentures of the Township to the total long-term debt of the Township and a description of the change, if any, in that estimated proportion since the previous year's report;
- (b) A statement as to whether, in his or her opinion, all construction financing debentures were made in accordance with the statement of policies and goals relating to construction financing adopted by the Township;
- (c) An update of the detailed estimate with respect to the terms of the Township's expectations of revenue generation from the undertaking for which the construction financing debentures were issued;
- (d) A record of the date of the repayment of each instalment of principal, interest or both principal and interest made during the period of construction of the undertaking for which the construction financing debentures were issued;
- (e) A statement of the outstanding instalments of principal, interest or both principal and interest repayable during the currency of the construction financing debentures that will be due and payable in each year; and
- (f) Such other information that the Council may require or that, in the opinion of the Chief Administrative Officer/Clerk/Treasurer should be included. O. Reg. 278/02, s.3 (2).

b) The Chief Administrative Officer/Clerk/Treasurer shall submit to Council when required, the following:

A report, before entering into a financing lease which is other than a non-material lease with a recommendation assessing the costs and financial and other risks associated with the proposed financing lease. This report shall include:

- (i) A comparison between the fixed and estimated costs and the risks associated with the proposed lease and those associated with other methods of financing;
- (ii) A statement summarizing, as may be applicable, the effective rate or rates of financing for the lease, the ability for lease payment amounts to vary, and the methods or calculations, including possible financing rate changes, that may be used to establish that variance under the lease;
- (iii) A statement summarizing any contingent payment obligations under the lease that in his or her opinion would result in a material impact for the municipality, including lease termination provisions, equipment loss, equipment replacement options and guarantees and indemnities;

(iv) A summary of the assumptions applicable to any possible variations in the lease payment and contingent payment obligations; and

(v) Any other matters the Chief Administrative Officer/Clerk/Treasurer or Council considers advisable.

A statement of policies and goals before passing a by-law providing for construction financing through the issue of construction financing debentures which shall consider:

- i) The fixed and estimated costs to the Township;
- ii) Whether the costs of the proposed financing for the construction of the undertaking are lower than other methods of financing available to the Township;
- iii) A detailed estimate with respect to the terms of the Township's expectations of revenue generation from the undertaking, once constructed;
- iv) The risks to the Township if the undertaking is not constructed or completed within the period of construction as estimated by Council; and
- v) The financial and other risks for the Township.

## ***RESPONSIBILITIES:***

### **Mayor**

The Mayor executes and shall sign appropriate documents on behalf of the Township with respect to the issuance of debt instruments of the Township.

### **Chief Administrative Officer/Clerk/Treasurer**

- Reviews and recommends the type and term of financing for capital projects and operating requirements;
- Calculates the financial debt and obligation limit for the Township as prescribed by the Act;
- In consultation with the fiscal agents, approves the timing and structure of debt instrument issues;
- Coordinates the preparation of debt instrument by-laws for Township Council;
- Executes and signs appropriate documents on behalf of the Township and performs all other related acts with respect to the issuance of debt instruments of the Township;