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P.O. Box 1749
Halifax, Nova Scotia
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Item No. 4

Committee of the Whole
February 2, 2016
February 3, 2016

TO: Chair and Members of Budget Committee of the Whole

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SUBMITTED BY: ____
Amanda Whitewood, Director of Finance and Information Technology/CFO

DATE: January 25, 2016

SUBJECT: Review of Debt Strategy

ORIGIN

THAT Committee of the Whole request a staff report for consideration during the 2016/17 budget discussion regarding a review and refresh of the 2009 HRM Revised Debt Servicing Plan, with an emphasis on capacity to fund state of good repair, particularly road maintenance, paying particular attention to ability to service debt over a five year term, (remove) and consistency with the spirit and intent of the 1999 Multi-Year Financial Strategy

LEGISLATIVE AUTHORITY

Debt Servicing Plan Original Implementation Date: June 22, 1999- Approved by: Regional Council
Date of Last Revision: November 17, 2009- Approved by: Regional Council.

RECOMMENDATION

The Budget Committee of the Whole recommends Halifax Regional Council

1. Confirm that the 2016-17 target for Tax Supported Debt continue to be based on a 3% decline in the debt per home;

2. Create a business case for Strategic Infrastructure Reserve, with an annual budget of $10m, whose purpose includes repaying principle and interest and leveraging cost-shared infrastructure programs; and,

3. Confirm that, final review pending, the 2016-17 average tax bill is to remain at same amount as in 2015-16.

BACKGROUND

At the time of amalgamation the approved debt of the former municipalities stood at $242 million. Following amalgamation, the costs of the new Otter Lake landfill, along with amalgamation transition and other costs, led to an increase in the debt to nearly $350m. The Multi-Year Financial Strategy of 1999 addressed this by limiting the approval of any additional debt to 80% of that being repaid. This approach was successful in reducing the high level of debt that existed. However, the debt targets did not allow for the substantial growth in homes that was occurring. Moreover, it meant that the municipality was losing out on potential capital opportunities on new services while also facing increasing pressure on its maintenance costs (“State of Good Repair”).

In 2008-09, Regional Council approved an additional $22m in debt above the debt targets. The following year it revised its debt strategy to reflect the continued growth of the municipality. Debt targets were tied to the number of homes with the intent being that the debt per home would decline by 3% each year. Simultaneously, Capital from Operating (which is a contribution from the operating budget to the Capital Budget) would increase by 3% per home, plus inflation. The goal of this policy was to:

- Grow the Capital Budget while reducing reliance on debt and increasing Capital from Operating
- Ensure that all State of Good repair was funded outside of debt (Capital from Operating, Gas Tax, reserves) and that debt was used was used for Growth and Service Improvement projects.

DISCUSSION

The current approach to debt has been very successful in reducing the organization’s reliance on debt. By 2016-17 “Tax Supported Debt” will have declined to $250.9m, almost to the level it was at the time of amalgamation twenty years ago. That decline occurred despite the fact that inflation has grown by 45% and the number of homes has increased by nearly 30%. Approximately 6% of revenue goes towards paying for tax supported principle and interest. Sometimes called the “interest bite”, this means that the municipality is in a strong position to repay its debt and that any pressure to reduce services or raise property taxes to pay those debt charges, is limited. The Province of Nova Scotia recommends a maximum 15% debt servicing ration. At 6%, Halifax is 60% below that level.

At the same time that debt has declined, Capital from Operating has increased substantially. The 2009 debt policy attempted to shift reliance from debt to Capital from Operating. In 1998-1999 when debt peaked at $347.5m, Capital from Operating was only $1.6m. By 2015-16 it was budgeted at $47m. In 2016-17 it is projected to be $41.3m. Along with gas tax, it covers 88% of the capital budget for State of Good Repair.

At the same time, however, Capital from Operating has placed considerable pressure on the operating budget at a time when the municipality is trying to eliminate or limit any increases in property taxation. If average property taxes are to remain flat or, at the most, grow at inflation, than the higher budget for Capital from Operating must be absorbed through efficiencies or other budget reductions. For instance, while inflation has increased 12% since 2009, Capital from Operating has increased nearly 30%. Hence there is some rationale for moderating the debt policy.

Staff reviewed the debt policy from two distinct perspectives. First, are the debt targets appropriate in light of attempt to fund the state of good repair? Secondly, how does the debt policy function with respect to large infrastructure investments?

Options for State of Good Repair:

Staff modelled a number of options for debt targets and considers three approaches to be the most viable:

First, the current target levels could continue. The current targets mean that almost 90% of the state of good repair budget can be funded without issuing debt. The increases in Capital from Operating that occur, however, are substantial and can make it more difficult to balance the budget without tax increases or service reductions. In the budget it is preparing staff have lowered capital from operating but have continued to base the 2016-17 target for Tax Supported Debt on a 3% decline in the debt per home.

The second option would provide a better balance between debt and Capital from Operating. Instead of debt declining 3% and Capital from Operating increasing 3% plus inflation, each of them would change by 3% plus half the rate of inflation. As a result, debt would decline more gradually while Capital from Operating would increase more gradually. The capital budget over a 10 year period would be approximately $10m higher, not a significant change.

A third option would be to approve a one-time debt increase of $10m for additional roads and street work, all of it state of good repair work. One time increases were done in 2008-09 and other exceptions have been made for debt funding outside the targets. With low interest rates it is possible that the additional work might increase the surface distress index (SDI) sufficiently to provide cost savings elsewhere in the streets and roads budget. However, engineering staff have concluded that they would be unable to deliver such a substantial increase in their capital work during the 2016-17 fiscal year.

On balance, it would seem appropriate to maintain the current approaches for debt and Capital from Operating but to undertake, during the following year, a much broader review that looks at the underlying fiscal and economic assumptions and critical key decisions such as; the level of the overall capital budget, tax levels, reserves and the capacity to undertake service enhancements. Therefore, it is recommended that the 2016-17 target for Tax Supported Debt continue to be based on a 3% decline in the debt per home.

Options for Large Infrastructure

Staff also reviewed the funding approach with respect to large infrastructure projects. In 2015-16 Council approved an additional 1 cent on the tax rate to fund large strategic projects that it could potentially undertake. These funds were a contribution to the Potential Strategic Growth Reserve (Q126). The intent was to allow funds to accumulate to pay for future large projects. These might include facilities for public safety, library and recreation. Individual projects have not been approved and detailed designs have not been finalized

Several factors were considered when reviewing this area. First, interest rates remain historically low; secondly, with the change in the Federal Government, additional Federal infrastructure funds are possible. Lastly, the finalization of the new solid waste contract has freed up reserve funds that would otherwise pay for future sold waste reserves. In total, $5.7m in reserve funds is available.

Staff reviewed three options in this area. First, a strategic investment reserve could be created with contributions of $10m per year ($4.3m from Q126 and $5.7m intended for solid waste cells). These funds would be used to pay the principle and interest costs for any additional debt. The $10m should be sufficient to support $75m in additional capital. If that work was cost shared three ways with the Federal and Provincial governments, the gross project costs would be as much as $225m.

A second approach would be to contribute the $5.7m to the already existing Potential Strategic Growth Reserve (Q126). This would allow the fund to grow substantially larger although it would take longer to fund what could be done under a new Strategic Infrastructure Reserve. In the interim, interest rates and construction costs are more likely to rise.

A third approach would be to use the $5.7m to increase Capital from Operating for a one-time addition to the streets and roads budget. However, as noted, staff would be unable to deliver such a substantial increase in their capital work during the 2016-17 fiscal year.

Recommendation

With respect to state of good repair issues, there is not strong evidence to recommend a change to the current funding of the 2016-17 capital budget, either through additional debt or Capital from Operating. Staff intends to continue reviewing the longer term fiscal outlook especially looking at various scenarios for capital budgeting, debt, reserves and taxation. It is recommended that the 2016-17 target for Tax Supported Debt continue to be based on a 3% decline in the debt per home.

For larger infrastructure projects, the “Strategic Infrastructure Reserve” offers an opportunity to take advantage of cost sharing and low interest rates. Combined with Federal/Provincial cost-sharing it could leverage up to $225m of capital work. As such, it is recommended that staff create a business case for a Strategic Infrastructure Reserve with an annual budget of $10m, whose purpose includes repaying principle and interest and leveraging cost-shared infrastructure programs.

FINANCIAL IMPLICATIONS

There are no immediate budget or financial changes due to the recommendations. However, staff will return with a business case for a new Strategic Investment Reserve and any additional changes required to other reserves or policies.

In the longer term it is expected that additional debt will be approved by Council but that the new reserve will have sufficient funds to offset the debt charges, thereby not creating any additional pressures to raise taxes. To date, no projects have been designed or approved for the new reserve or the existing Potential Strategic Growth Reserve (Q126). Any such projects require Council approval and a fuller review of all financial and service implications, including any costs to operate new facilities or assets.

COMMUNITY ENGAGEMENT

None.

ENVIRONMENTAL IMPLICATIONS

Implications not identified.

ALTERNATIVES

Alternatives for State of Good Repair:

(1) Adjust the debt targets (based on an amount per home) so that debt approved to be issued and Capital from Operating are both set at 3% plus half the rate of inflation. This is an acceptable option.

(2) Issue an additional $10m in debt for 2016-17 to be used for state of good repair road projects. This is not recommended as staff would be unable to deliver on the additional work within the 2016-17 fiscal year.

Alternatives for Large Infrastructure

(3) Contribute the available $5.7m to the already existing Potential Strategic Growth Reserve (Q126) and not to a new Strategic Infrastructure Reserve. This is an acceptable option but is less preferable than the recommended option.

(4) Contribute the available $5.7m to Capital from Operating and not to a new Strategic Infrastructure Reserve. The funds would be used for additional state of good repair road projects. This is not recommended as staff would be unable to deliver on the additional work within the 2016-17 fiscal year.

ATTACHMENTS

Review of Debt Strategy Presentation

A copy of this report can be obtained online at http://www.halifax.ca/council/agendasc/cagenda.php then choose the appropriate meeting date, or by contacting the Office of the Municipal Clerk at 902.490.4210, or Fax 902.490.4208.

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Review of Debt Strategy

Committee of the Whole

February 2, 2016

Outline

- Committee of the Whole Motion
- Capital Budget Concepts
  - – Current Debt Targets
- Trends in Debts and Capital from Operating
    - Total, per dwelling with cpi, %rev, %gdp, P&I
    - Cap Oper
- Opportunities/Policy Framework:
  - – Debt Targets (3 options)
  - – Approach on Large Infrastructure (3 options)
- Recommendations

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COW Motion – Dec 2, 2015

THAT *Committee of the Whole request a staff report for consideration during the 2016/17 budget discussion regarding a review and refresh the 2009 HRM Revised Debt Servicing Plan with an emphasis on capacity to fund state of good repair, particularly road maintenance, paying particular attention to ability to service debt over a five year term, and consistency with the spirit and intent of the 1999 Multi-Year Financial Strategy.*

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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
   - Operating Budget
4. **Replace** the Asset
   - Growth and Service Improvement Projects
     - Replacement Reserves

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Home for Sale

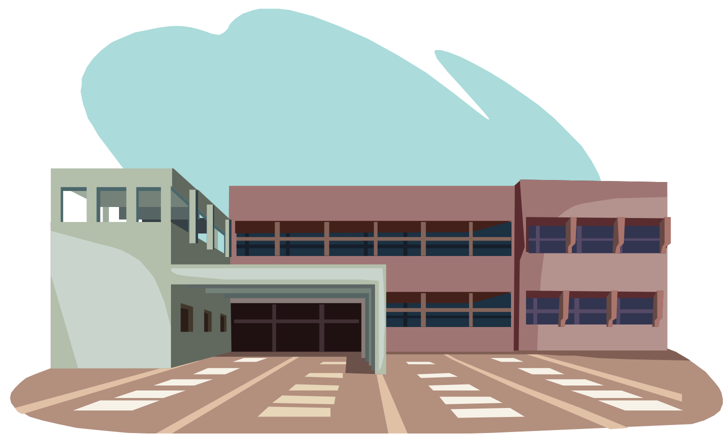
Cost is **$180,000** → Capital Budget

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

Halifax Budget



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
  - Future debt payments will put pressure on taxes

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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

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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 includes debt approved by Council but not yet issued.

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Why Have Debt Targets

- Targets are guidelines for Council
  - Exceptions are allowed
- 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
- Five Year Debt Targets ended in 2014-14
  - Followed existing practice since than

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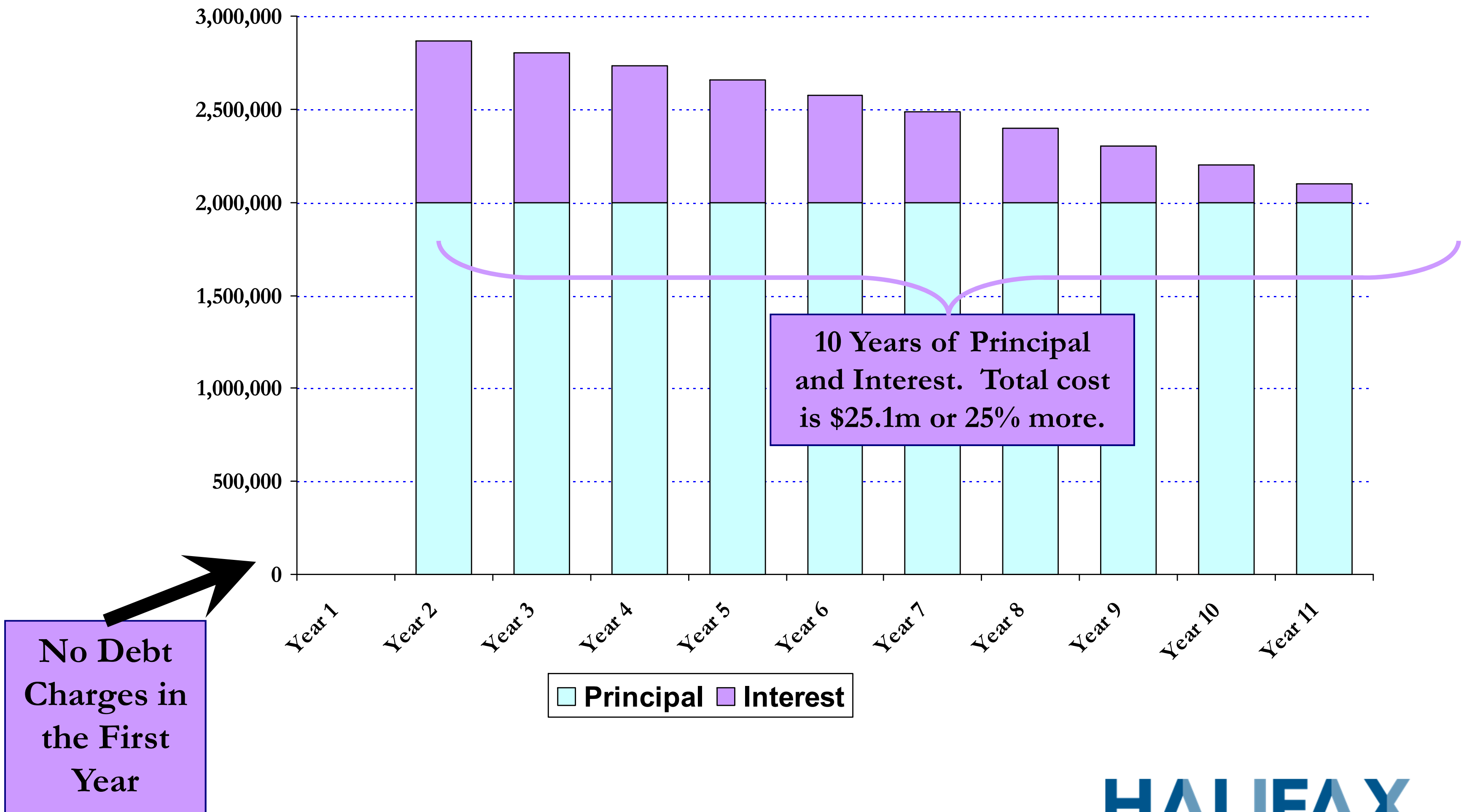
Example of $20m in Debt



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Debt Targets (2009-10 to 2013-14)

- The Debt Servicing Plan targets were set in 2009 for five years 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

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Exceptions are Allowed

- To advance projects faster than would otherwise be possible
  - Are there cost savings that can be achieved or new revenues produced by doing the project sooner? Eg LED Streetlights, Cogswell
  - 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?

What is the Right Amount of Debt? Our Policy Framework

- 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

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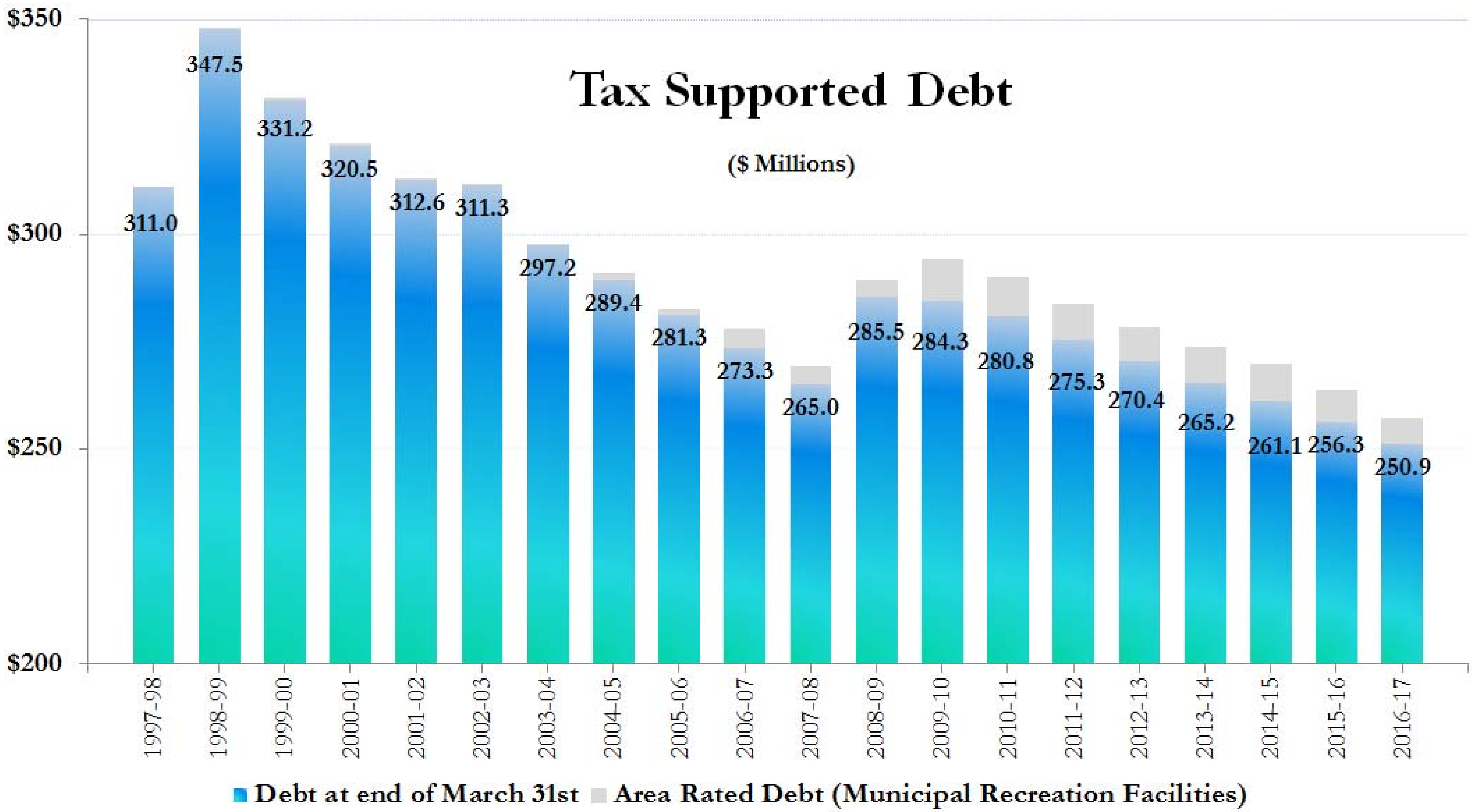

Debt includes funding that is approved, issued and work-in-progress (WIP) as of March 31st year-end.

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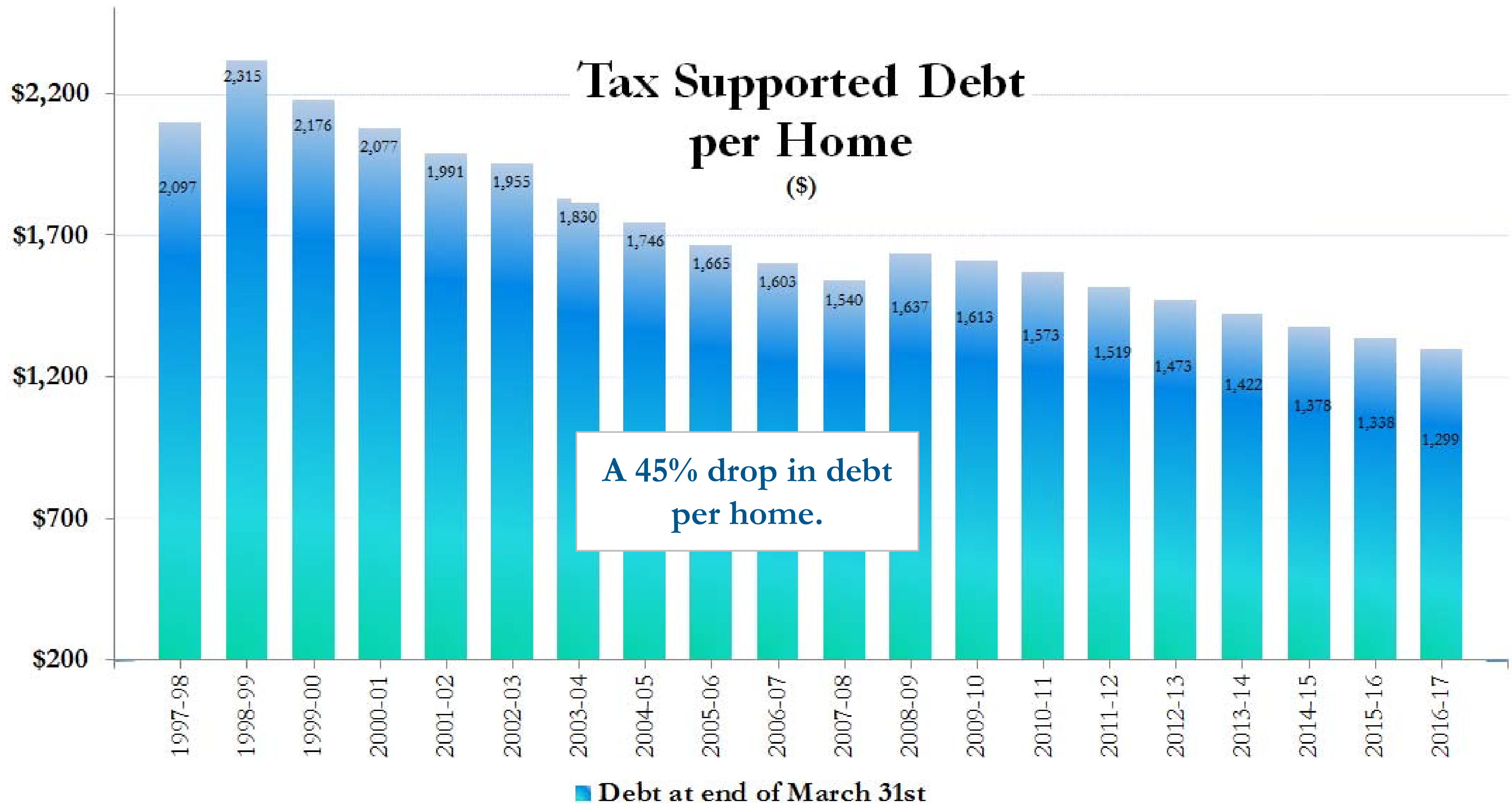

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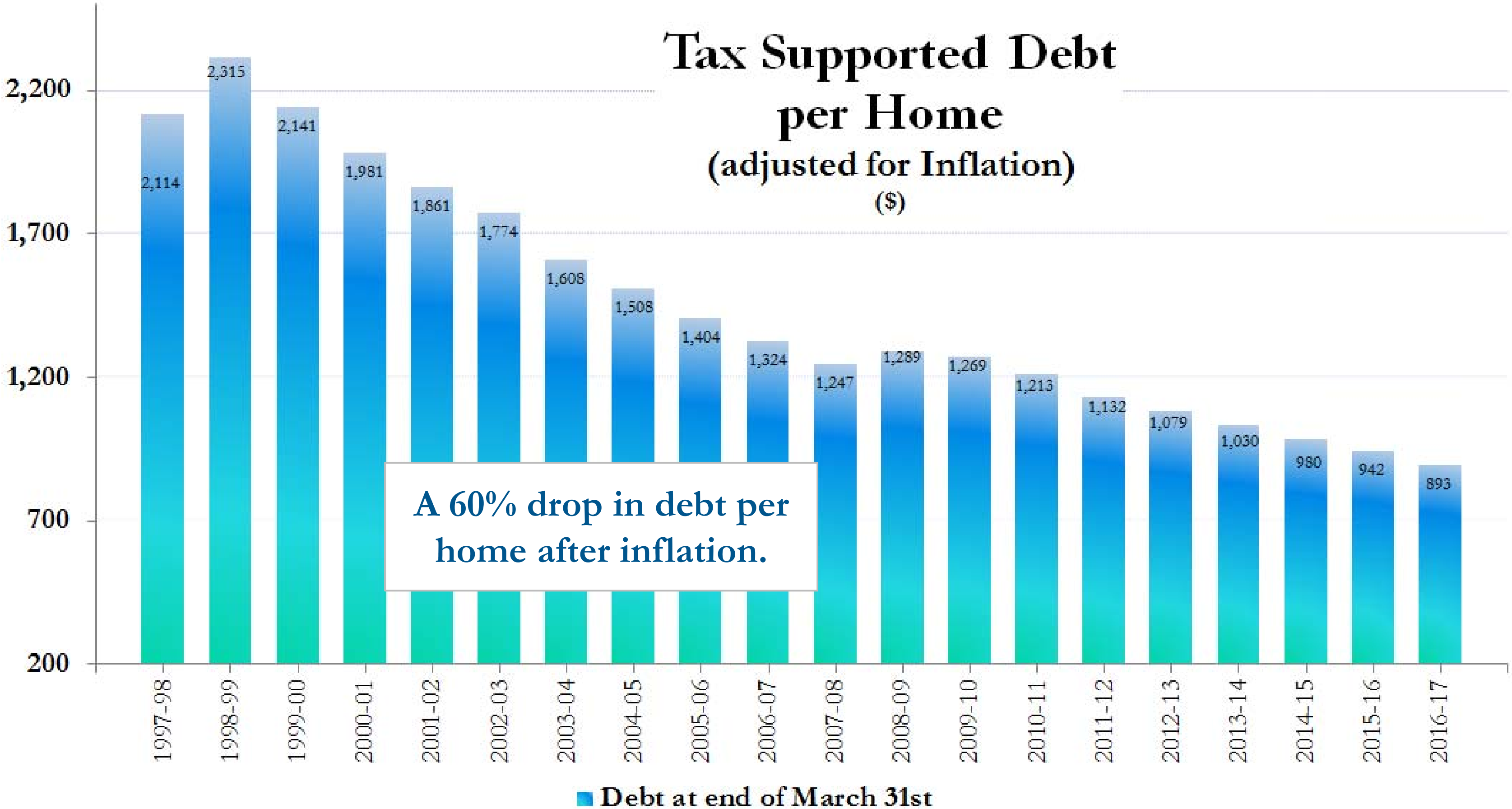

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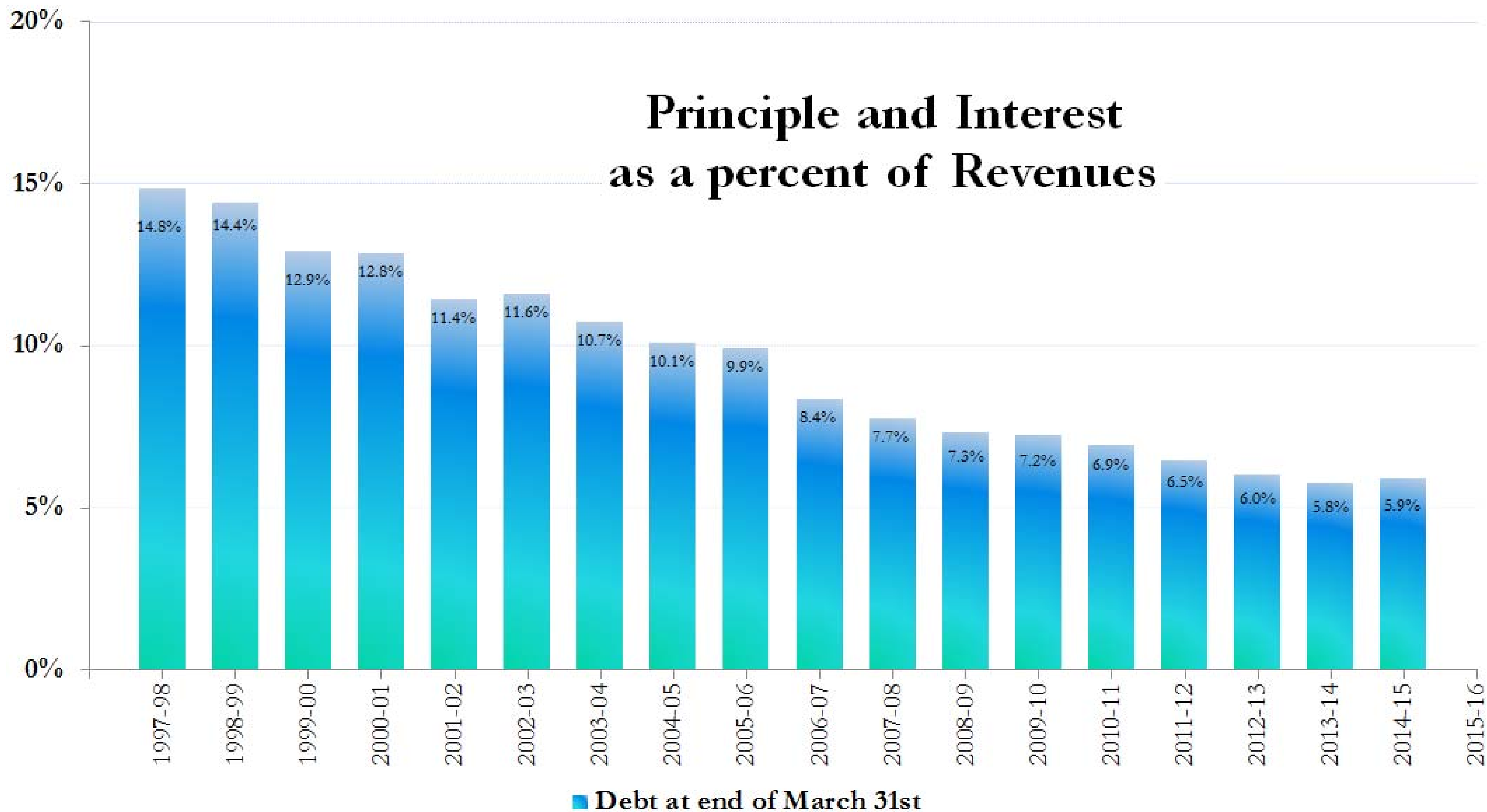

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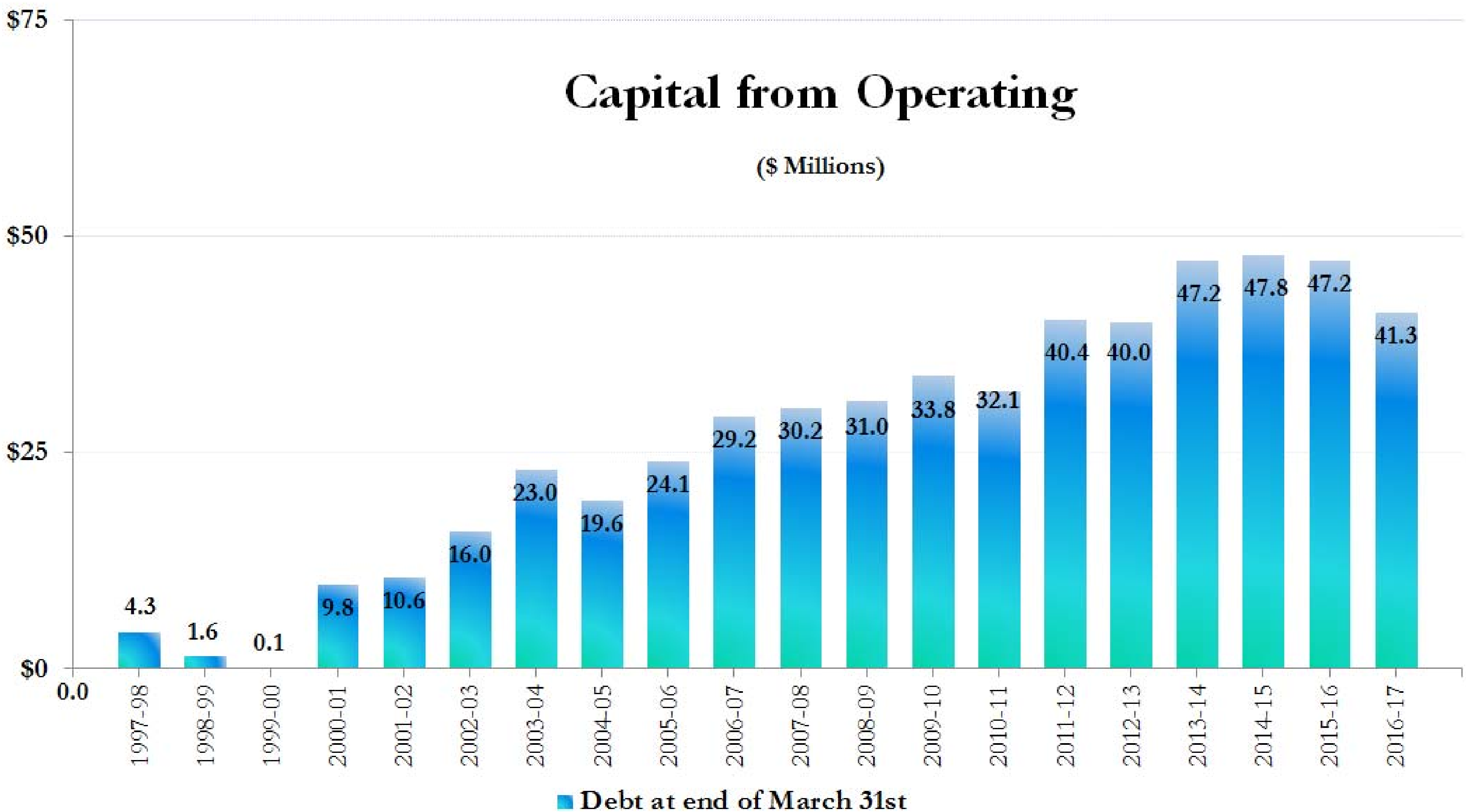

Debt includes funding that is approved, issued and work-in-progress (WIP) as of March 31st year-end.

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Observations

- Strong Declines in Debt
- Non-Debt pays for 90% of state of good repair
- Capital Budget is placing pressure on operating budget, hence taxes
  - Capital from Operating
  - Operating Costs of new assets

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Opportunities/Policy Framework

- Are we following appropriate debt targets?
  - State of Good Repair (eg Roads)
  - Low interest rates

- How to deal with large infrastructure projects
  - Council establish Potential Strategic Growth Reserve (Q126) in 2015-16 through 1 cent on Taxes ($4.3m)
  - Upcoming Federal Infrastructure program(s)

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Options for Debt Targets

1. Current Targets (Status Quo)
   - maintain current per home targets

2. Modify per home targets
   - Improved balance debt, capital from operating targets

3. Approve one-time amount of $10m for state of good repair in Streets and roads.

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Current Targets

- Per Home Targets:

  - **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)

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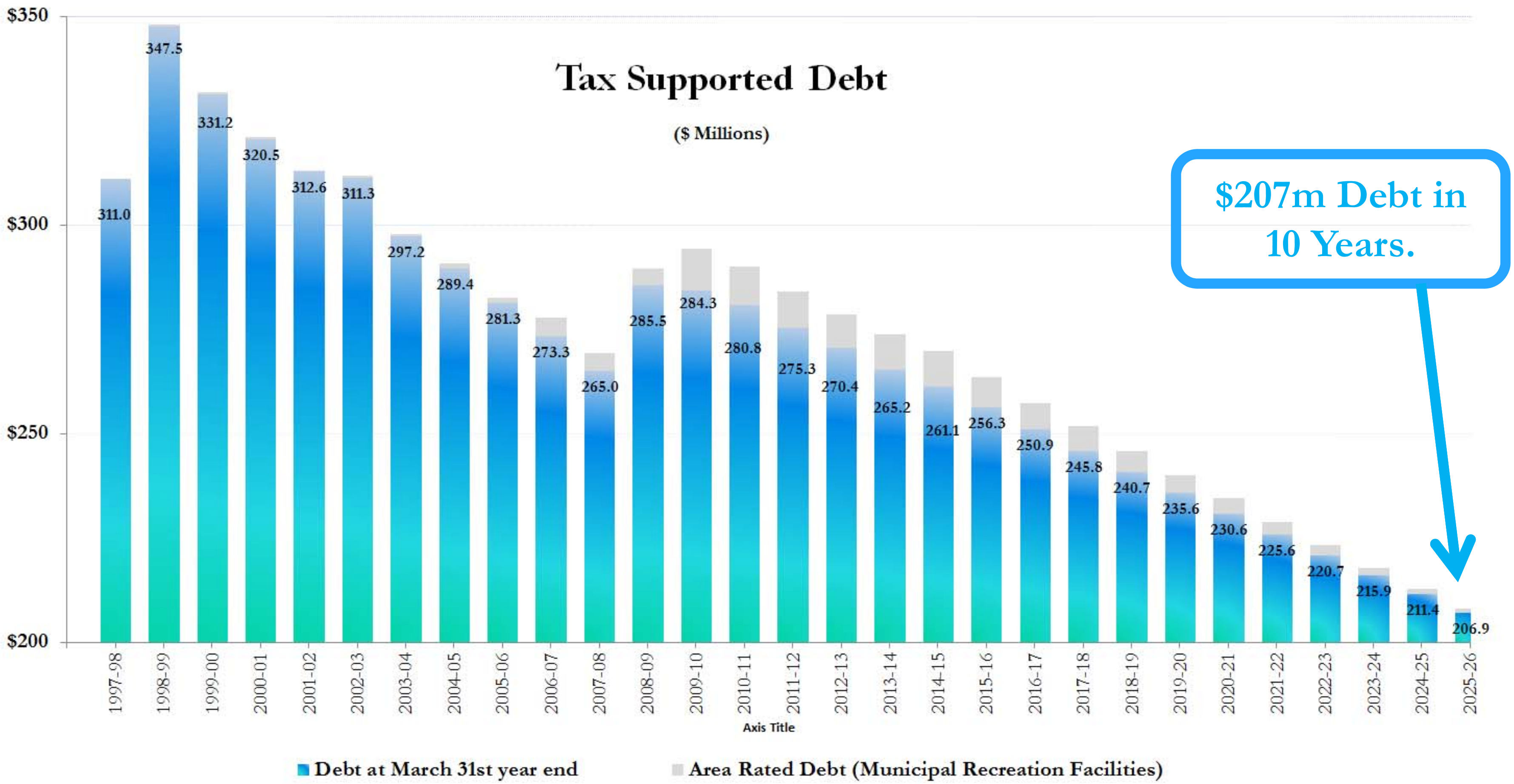
Current Targets in 10 Years Time



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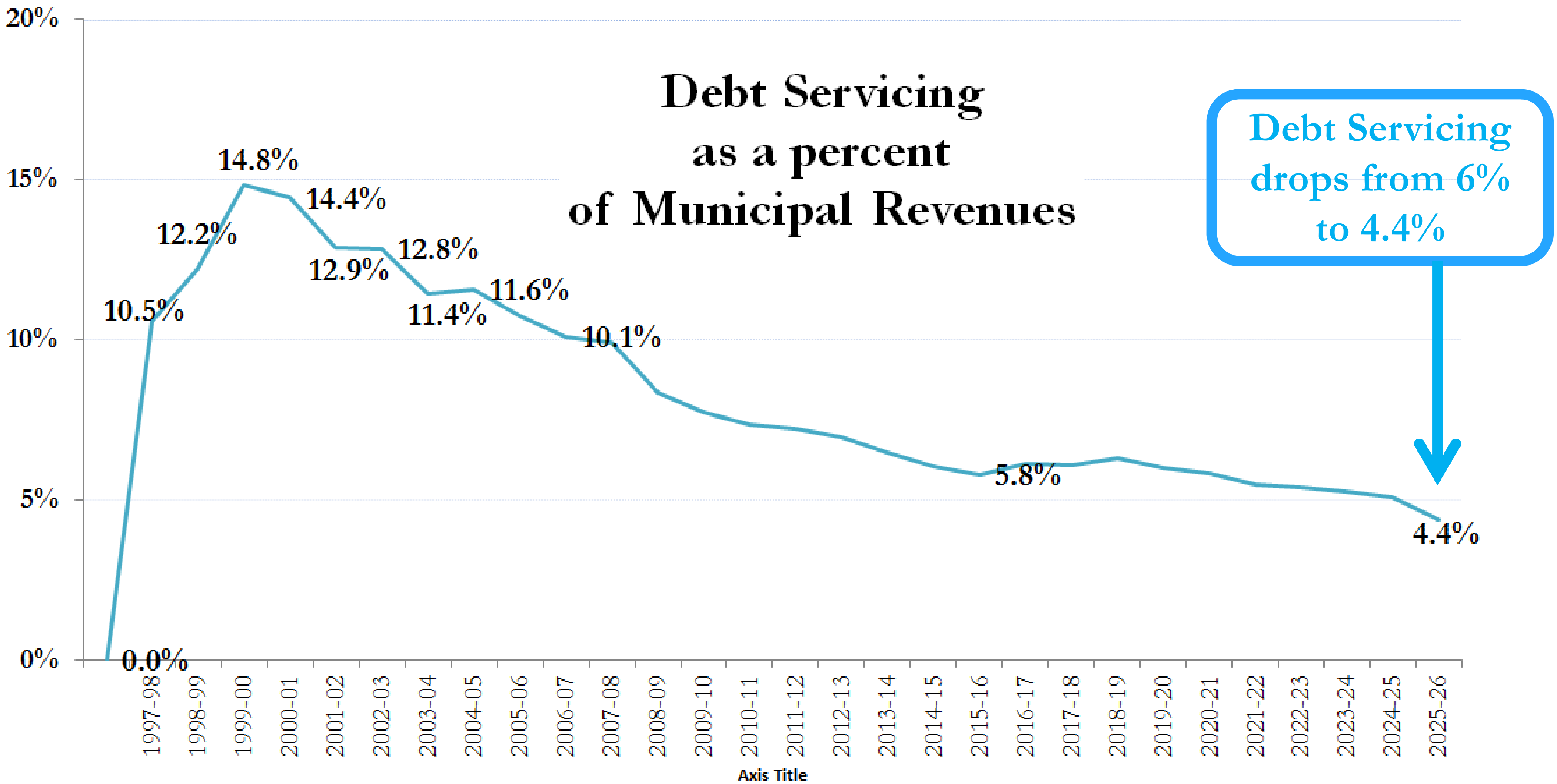
Current Targets in 10 Years Time



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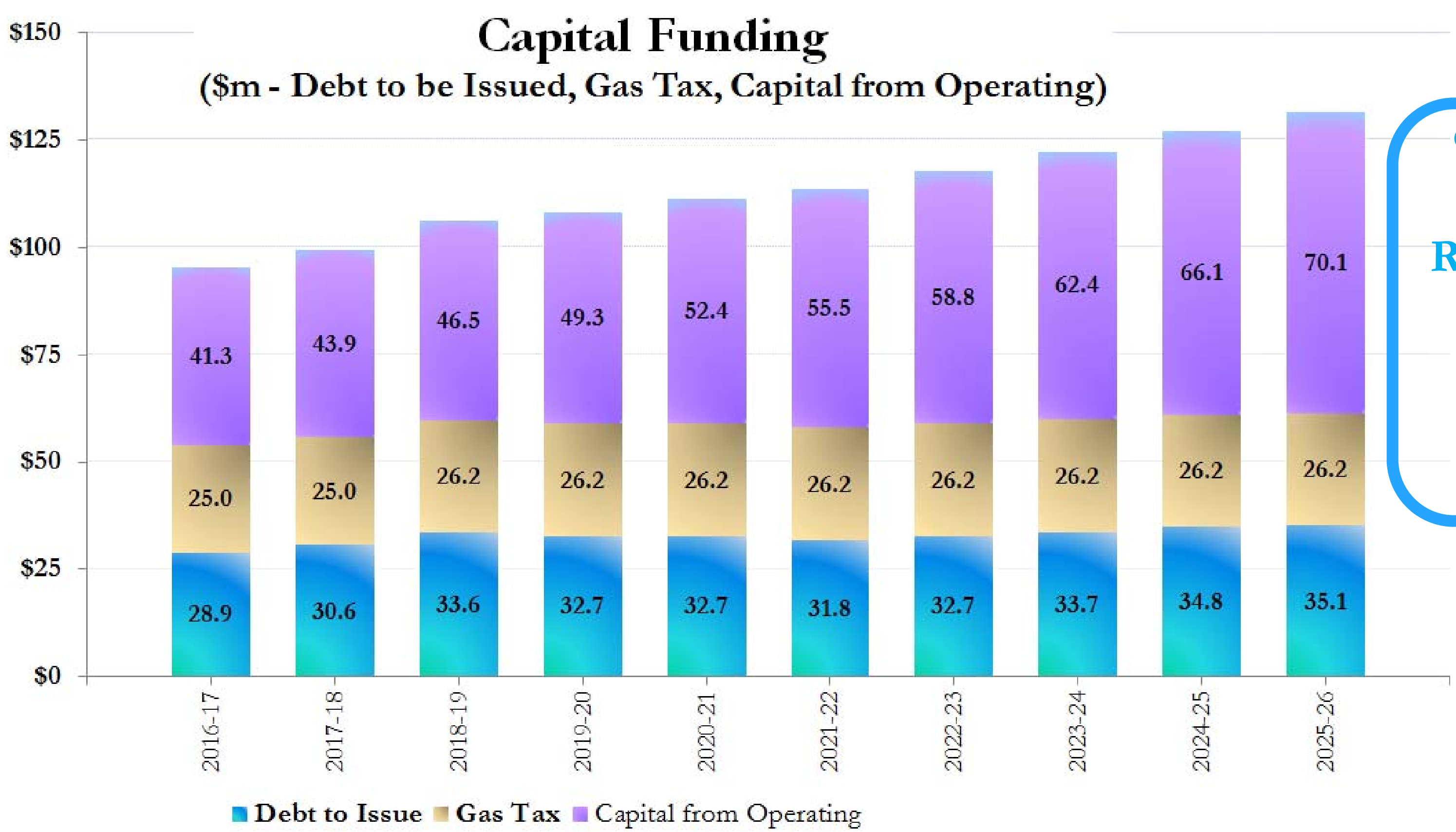
Current Targets in 10 Years Time



90% of State of Good Repair covered by Gas Tax and Capital from Operating

Modified Targets

- Per Home Targets:

  - **<u>Tax Supported Debt</u>** should decline by 3% + half the consumer price index

  - **<u>Capital from Operating</u>** should increase by 3% + half the consumer price index

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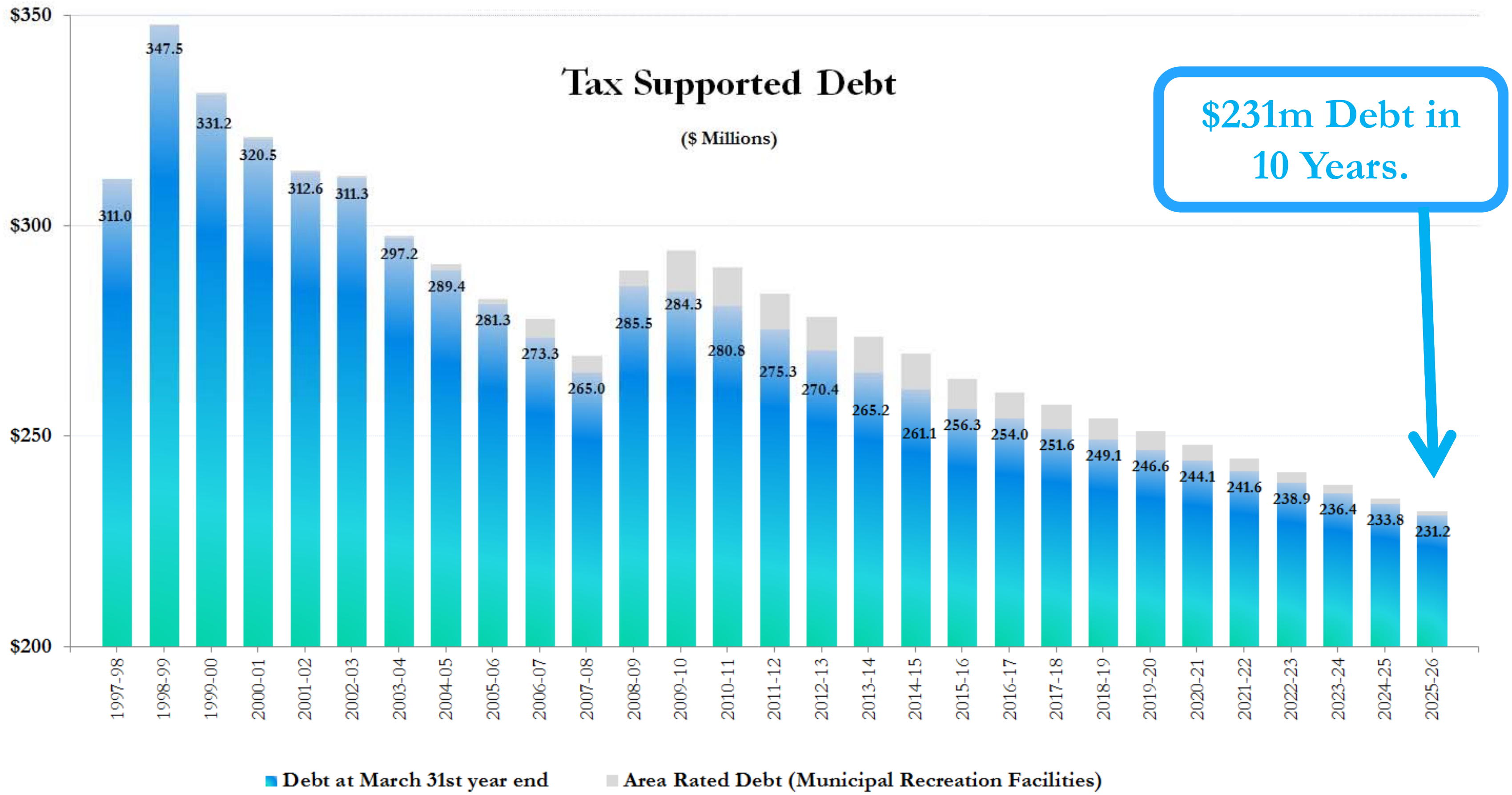
Modified Targets



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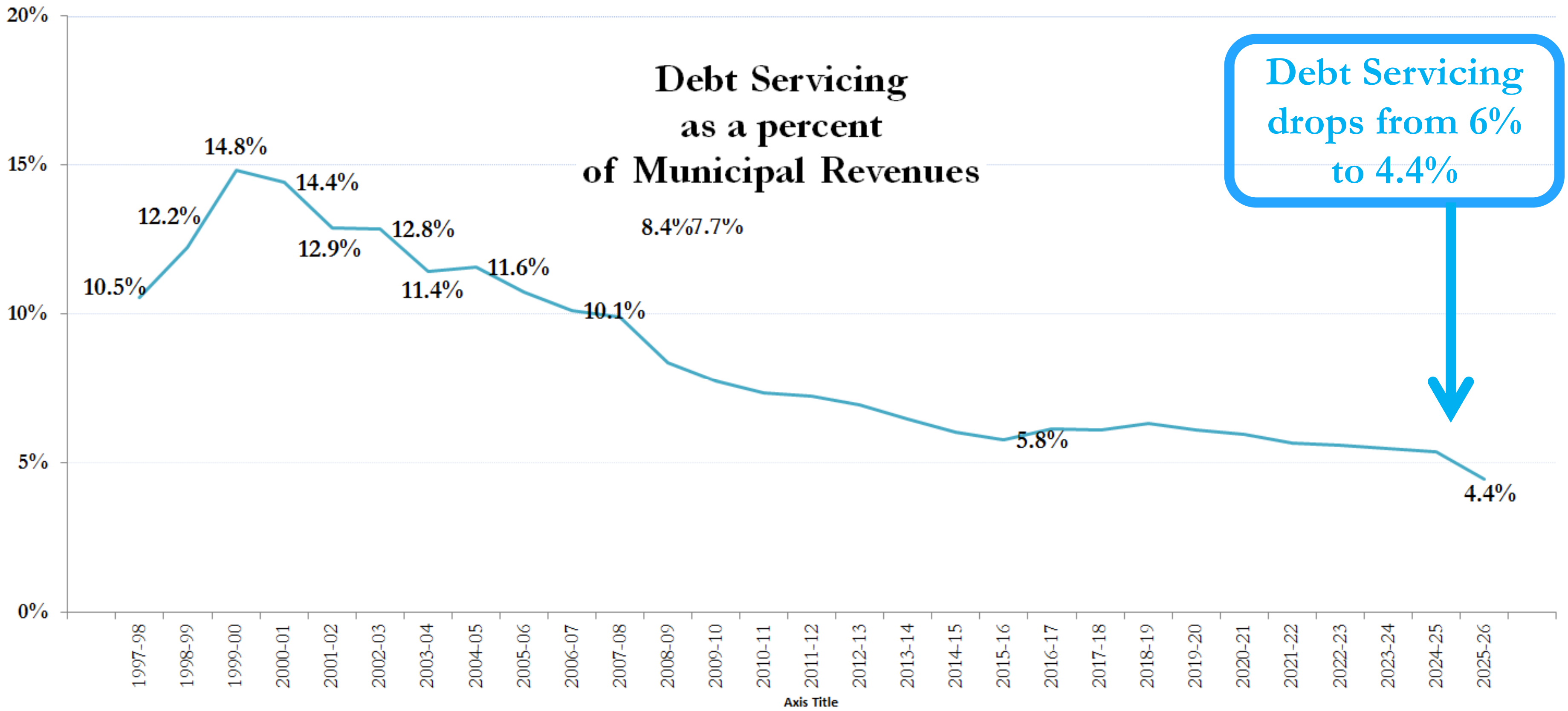
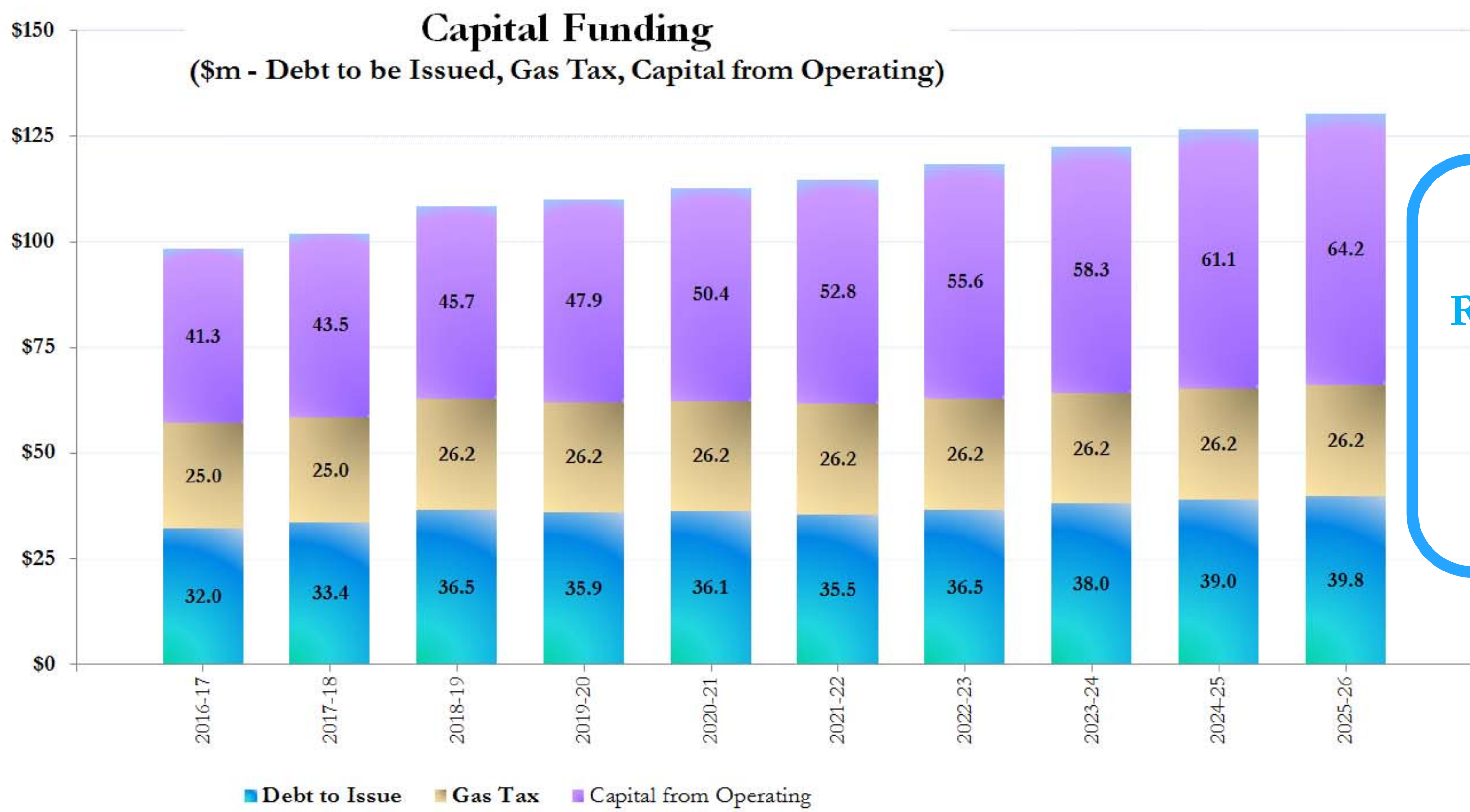
Modified Targets



Debt includes funding that is approved, issued and work-in-progress (WIP) as of March 31st year-end.

Modified Targets



88% of State of Good Repair covered by Gas Tax and Capital from Operating

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One Time Debt Increase

- Maintain current Per Home Targets.

- Approve additional $10m in debt for 2016-17

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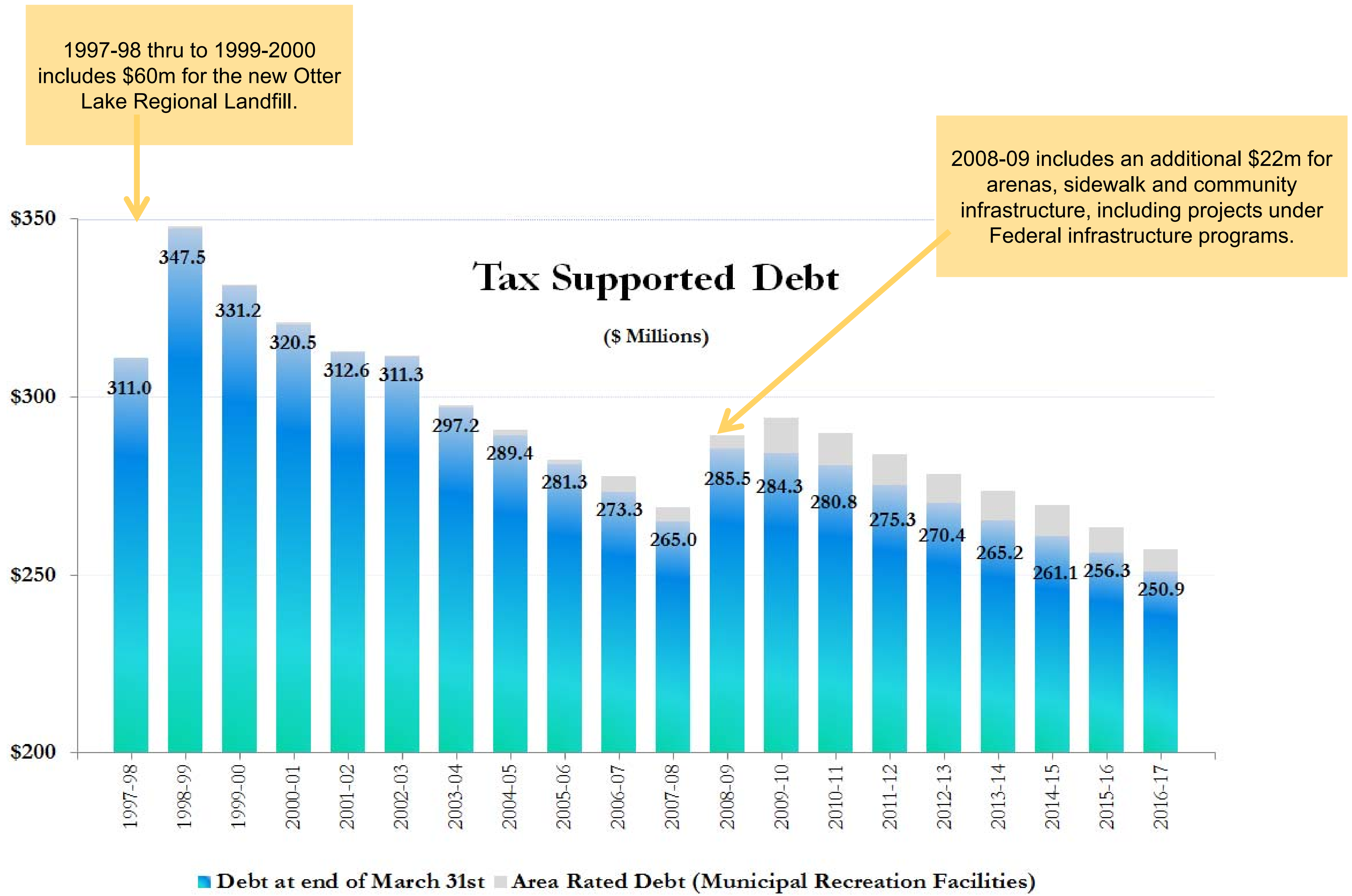
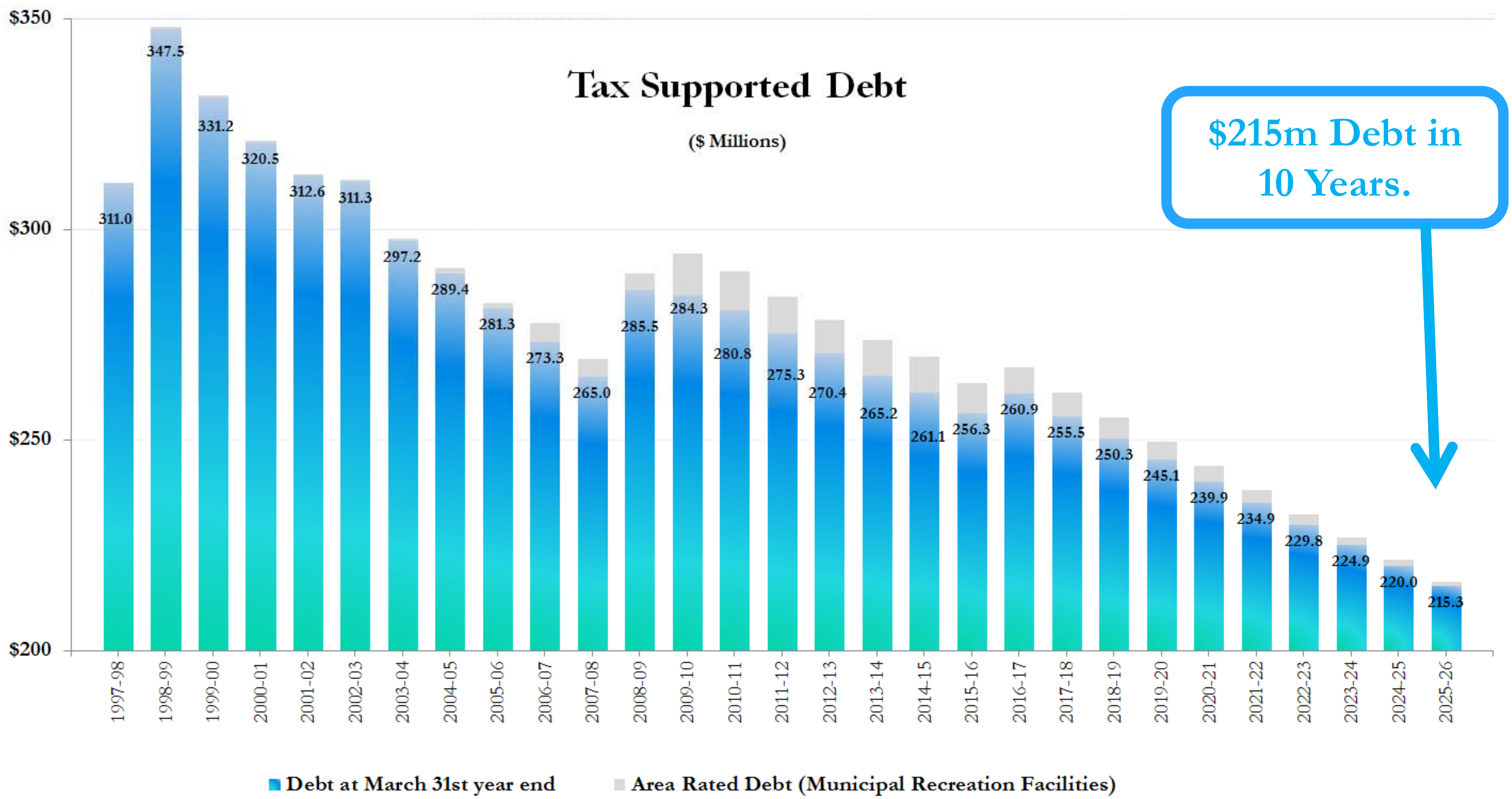

Tax Supported Debt
($ Millions)
1997-98 thru to 1999-2000 includes $60m for the new Otter Lake Regional Landfill.
2008-09 includes an additional $22m for arenas, sidewalk and community infrastructure, including projects under Federal infrastructure programs.
$350
$300
$250
$200
311.0
347.5
331.2
320.5
312.6
311.3
297.2
289.4
281.3
273.3
265.0
285.5
284.3
280.8
275.3
270.4
265.2
261.1
256.3
250.9
1997-98
1998-99
1999-00
2000-01
2001-02
2002-03
2003-04
2004-05
2005-06
2006-07
2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
Debt at end of March 31st
Area Rated Debt (Municipal Recreation Facilities)

One Time $10m Debt Increase



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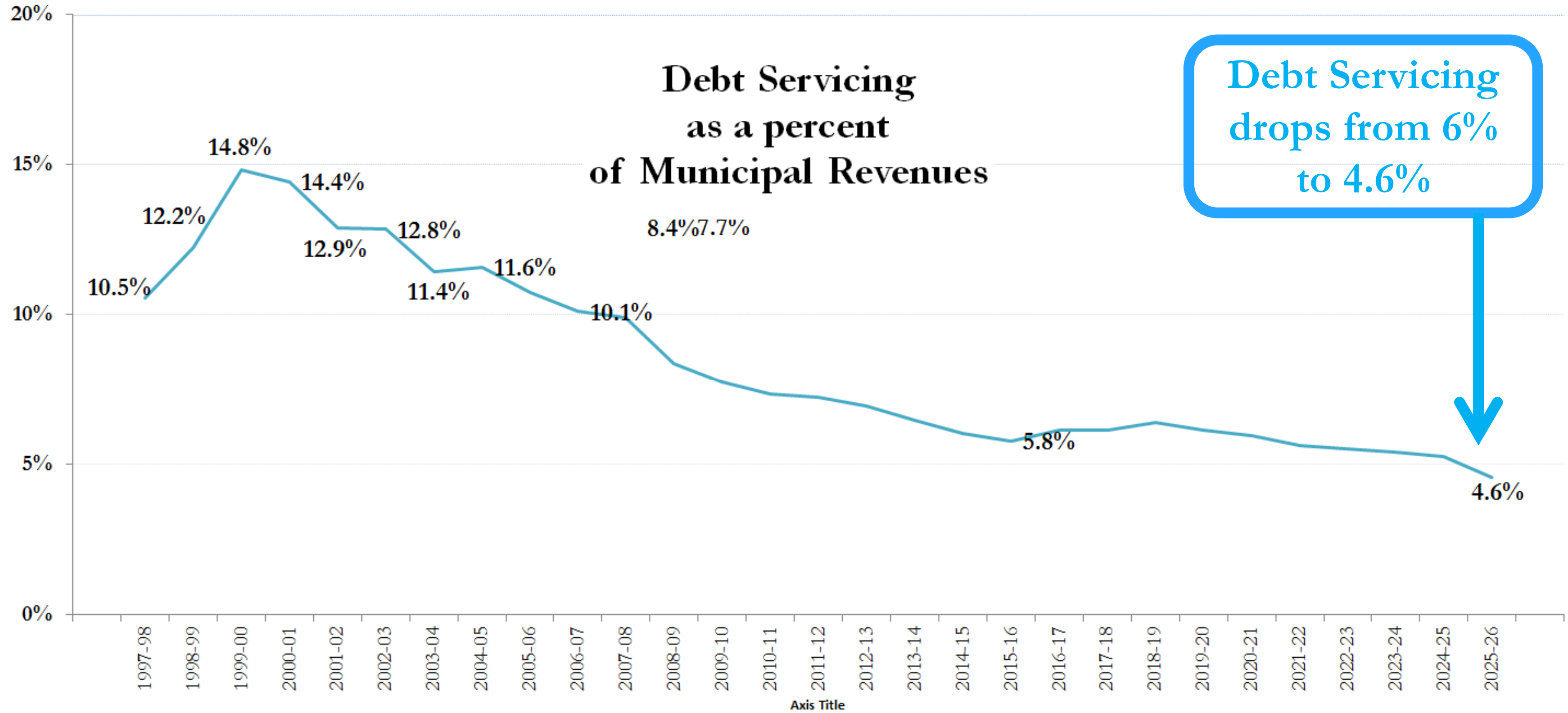
One Time $10m Debt Increase



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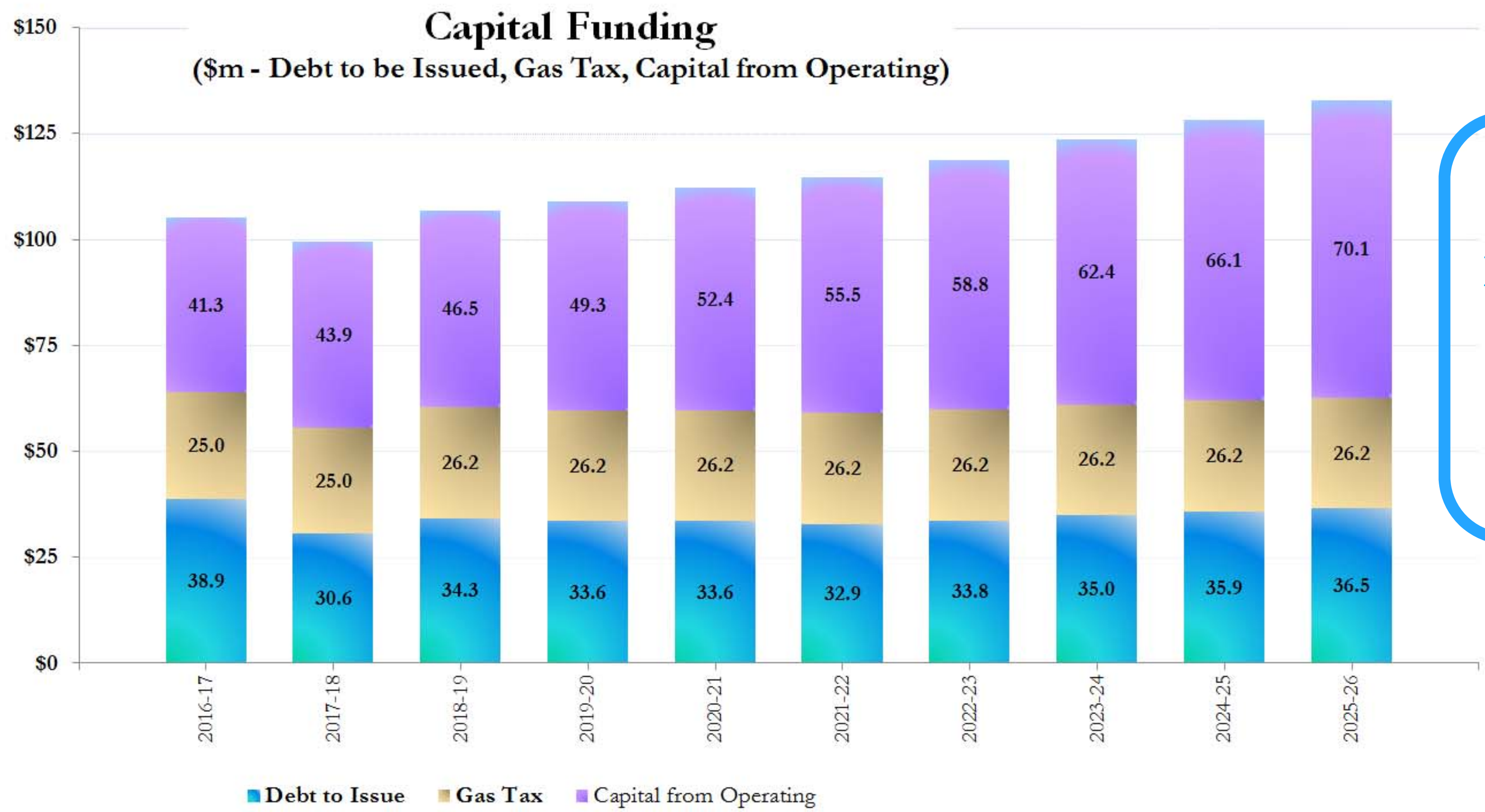
One Time $10m Debt Increase



90% of State of Good Repair covered by Gas Tax and Capital from Operating

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Conclusions on Debt Targets

- Continue to target state of good repair work through capital from operating.

- For 2016-17, continue with the budgeted approach
  - Debt estimated to decline to $250.9m
  - Capital from Operating set at $41.3m
    - Decline from 2015-16
  - Insufficient staff resources to deliver the additional roads and streets work

- For 2017-18 and future years, staff will return with longer term fiscal strategy that links key Council assumptions and decisions:
  - Tax Levels
  - Debt, Cap from Operating and Reserves
  - Capital Budget (enhancements and state of good repair)
  - Service Enhancements

Approach on Large Infrastructure

- Large infrastructure projects
  - In in 2015-16 Council established the Potential Strategic Growth Reserve (Q126) using existing funds and an additional 1 cent on Taxes ($4.3m).
  - Future projects might include facilities for public safety, library, recreation. Individual projects not approved.

- Current considerations:
  - Possible new Federal Infrastructure funding(s)
  - Interest rates continue at historic lows
  - Significant savings confirmed due to new solid waste contract:
    - Elimination of Cell Reserve means $5.7m can be re-directed.

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Options on Large Infrastructure

4. Use available funds to leverage infrastructure
   - Use existing $4.3m plus $5.7m in savings and create a $10m reserve to pay off future debt service costs.
     - Can issue nearly $75m in debt, repay using the $10m annual fund, and still maintain flat taxes for 2016-17.
5. Contribute $5.7m in savings to the existing reserve and build up balance to pay for large infrastructure.
6. Use $5.7m to pay for one-time capital from operating increase in additional streets and roads capital work.

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Strategic Infrastructure Reserve

- $10m Fund would pay down the principle and interest on approximately $75m.
- If the Federal and Provincial governments cost-shared at one-third each, this would leverage a $225m project(s).
- No tax increase is required to fund the repayment of this debt.
  - Takes advantage of low interest rates and possible Federal programs.
  - Additional operating costs of any new asset would need to be reviewed.

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Summary

	Options for Targets	
1	**Current Targets**	Sufficient funding for 2016-17 but review for 2017-18.
2	**Modify Targets**	Slight increase in capital budget. ($24m over 10 years).
3	**One-Time Increase in debt of $10m (Roads)**	Insufficient staff capacity to deliver additional work in 2016-17.
	Options for Large Infrastructure	
4	**Create Strategic Infrastructure Reserve**	Takes advantage of cost sharing and low interest rates. (Leverages $225m). Significant design work required.
5	**Increase Strategic Potential Reserve by $5.7m**	Interest rates and cost may rise while funding reserve. Significant design work required.
6	**One-Time Increase in capital from operating of $5.7m (Roads)**	Insufficient staff capacity to deliver additional work in 2016-17.

Recommendations

- Confirm that the 2016-17 target for Tax Supported Debt continue to be based on a 3% decline in the debt per home.
- Create business case for Strategic Infrastructure Reserve with annual budget of $10m.
  - Purpose includes repaying principle and interest and leveraging cost-shared infrastructure programs.
- Confirm 2016-17 average tax bill to remain at same amount as in 2015-16.