The Corporation of the City of Kawartha Lakes

Council Report

Report Number CORP2017-020

Date: July 11, 2017
Time: 2:00 p.m.
Place: Council Chambers

Ward Community Identifier: All

Subject: 10-Year Financial Plan

Author Name and Title:
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Recommendation(s):

RESOLVED THAT Report CORP2017-020, 10-Year Financial Plan, be received;

THAT the 10-Year Financial Plan, attached as Appendix B to Report CORP2017-020, be adopted as a guiding framework for future operating and capital budgets and the transition to long-term financial sustainability;

THAT a transitional increase in tax-supported debenture funding of $25,000,000 be approved for the purpose of implementing the 10-Year Financial Plan, and be maintained and reported on separately from other debt until it is retired;

THAT the capital projects identified in Appendix C to Report CORP2017-020 be financed by this debenture whereby the resulting displaced tax levy and reserve financing is transferred to the Capital Reserve or another reserve as may be required; and

THAT the tax-supported Infrastructure Levy be collapsed into the General Tax Levy and the water and wastewater Infrastructure Levies be collapsed into their respective fixed user fees.

Department Head: _____

Financial/Legal/HR/Other: _____

Chief Administrative Officer: _____

Background:

Since 2012, asset management and long-term financial planning have received increasingly greater emphasis throughout Ontario's municipal sector. In order to remain eligible for capital grants, such as the Federal Gas Tax Program and the Ontario Community Infrastructure Fund, Ontario municipalities must have a comprehensive asset management plan (AMP).

Now that almost all Ontario municipalities have an AMP, the Province is moving to establish a legislative framework and a degree of standardization for municipal asset management. A forthcoming asset management regulation under the *Infrastructure for Jobs and Prosperity Act* will, among many other things, make municipal AMPs mandatory.

While the City's 2014 AMP represented a good start to municipal asset management, it does not meet the new standard of comprehensiveness established by the Federal Gas Tax Program or the forthcoming asset management regulation. Moreover, AMPs are living documents and must therefore be updated regularly to remain effective and relevant tools.

The City retained Public Sector Digest Incorporated, the City's asset management software provider, to prepare the 2017 AMP to a comprehensive standard. The AMP forecasts anticipated tax-supported and water/wastewater lifecycle capital needs based on maintaining current municipal service levels as established by Council through the 2015-2017 Core Service Review or otherwise.

In particular, Council's May 16th, 2017 adoption of the 5-year capital plan based on the 2016 Roads Needs Study has been incorporated into the AMP for the relevant roads capital programs. So too has the relatively new Fleet Policy and its Management Directive setting out lifecycles, replacement costs and rental rates for vehicles and related equipment.

The AMP further incorporates anticipated major non-lifecycle capital replacements, growth-related capital needs as identified in the 2015 Development Charges Background Study and allowances for capital expansions staff have identified as having previously been conceptually considered at Council.

On May 30th, 2017, Council was presented with the main findings of the AMP as well as potential supportive financial strategies. The presentations showed the City has a $10M tax-supported infrastructure deficit that must be eliminated as soon as possible. They also demonstrated the need to bring tax and user rate support for capital up to sustainable levels and to build healthy capital reserve balances to promote the stabilization of tax and user fee increases and insure against unforeseen capital needs and emergencies. All these needs are components of long-term financial sustainability.

Replacement Cost of Asset Portfolio by Asset Class (2017$)*				
Asset Class	**Tax-Supported**	**Water**	**Wastewater**	**Total**
Natural Resources	399,768,525	5,185,320	7,777,980	412,731,825
Infrastructure	1,887,889,825	236,989,729	269,986,409	2,394,865,963
Facilities	282,170,583	14,124,000	9,213,000	305,507,583
Equipment	102,671,535			102,671,535
Total	**2,672,500,468**	**256,299,049**	**286,977,389**	**3,215,776,906**

*Includes depreciable and non-depreciable assets, and excludes social housing assets. Water and wastewater portions of natural resources are based on approximate land value shares.

With a municipal asset portfolio worth over $3.2B in replacement value (see above table), the importance of the City's long-term financial security cannot be overstated. However, long-term financial planning cannot consider only capital needs; it must also consider the various constraints over how those needs can be met. Prominent examples of such are legislation, ratepayer affordability, debt servicing capacity, reserve integrity, operating cost pressures and asset-related risk. With these capital needs and constraints considered jointly, staff has developed a 10-Year Financial Plan for implementing the AMP and achieving long-term financial sustainability for the City by 2027.

Like with any plan, the AMP and 10-Year-Financial Plan are expected to be adjusted annually to account for ever changing circumstances and direction. For instance, assets might deteriorate and require replacement faster or slower than projected. Similarly, with respect to expansionary projects and new initiatives, Council might choose to delay, accelerate or not pursue them. Another possibility is an unexpected major asset failure, requiring debenture issuance if the cost cannot be adequately absorbed by insurance coverage and/or the capital reserve. The annual budget process provides a useful venue for the discussion and determination of such adjustments.

This report seeks Council's direction on the City's transition to long-term financial sustainability via the 10-Year Financial Plan.

Rationale:

The 10-Year Financial Plan is formulated around three distinct dimensions of financial sustainability:

1. Capital Expenditure Sustainability: This refers to bringing capital expenditure in line with expected capital need, eliminating the infrastructure deficit.

2. Tax/Utility Rate Support Sustainability: This refers to brining tax/utility rate support of capital in line with that required once all other funding sources have been accounted.

3. Capital Reserve Sustainability: This refers to building healthy capital reserve balances to promote tax/utility rate stabilization and insure against unanticipated capital needs and emergencies.

Given their nature and the strategy of transitional reliance on capital reserves, these are achieved in the order in which they are listed above. All else equal, the preference clearly is to achieve these objectives sooner rather than later, however other considerations play an integral role in determining the viable path and timing of financial sustainability. Accordingly, the financial plan reflects the following main considerations:

1. Service Deficiencies: The later capital expenditure sustainability is achieved, the greater realized municipal service levels will deteriorate and fall below expectations and/or legislated standards (e.g. gravel road deficiencies).

2. Asset-Related Risk: The later capital expenditure sustainability is achieved, the greater the risk of unacceptable asset performance, deterioration or failure and related emergency costs (e.g. City Hall roof failure).

3. Ratepayer Affordability: The later tax/utility rate support sustainability is achieved, the greater the need for tax/utility rate increases in the mid and latter part of the planning horizon and hence for transitional reliance on debt and capital reserves.

4. Debt Capacity: The nature and financing of existing and recently closed capital projects limit the amount of debenture that can be issued immediately, and the *Municipal Act* and Ministry of Municipal Affairs and Housing set additional limitations and guidelines on municipal debt.

5. Capital Reserve Integrity: Transitional reliance on capital reserves to support the phase-in of capital expenditure and tax/utility rate support sustainability is subject to minimum transitional reserve balances to maintain reserve integrity.

6. Operating Pressures: Accumulated and arising operating pressures prolong the transition to sustainability as they result in less tax/utility rate support available for capital and hence greater need for transitional reliance on capital reserves.

In essence, the recommended approach in the financial plan achieves sustainability as soon as possible within the planning horizon subject to an acceptable sequence of declining tax/utility rate increases, the constraint on immediate transitional debt issuance and maintenance of an appropriate minimum capital reserve balance each year.

Tax-Supported Portfolio

Under the recommended 10-Year Financial Plan, capital expenditure, tax support and capital reserve sustainability are attained in 4 years, 6 years and 10 years, respectively, facilitated by an issuance of $25M in transitional debenture. This strategy is premised on collapsing the tax-supported Infrastructure Levy into the General Tax Levy.

The transitional debenture required is to be issued against existing and recently closed eligible capital projects and incurred in 2017-2018 to take advantage of historically low interest rates. This frees up tax levy and reserve financing that then infuses the capital reserve (or other reserves as may be required as the term “capital reserve” is meant to also represent reserves with equivalent function).

Over time, the capital reserve is drawn down to facilitate the phase-in of capital expenditure and tax support increases and the stabilization of tax increases. The most critical of these increases are those that occur before the infrastructure deficit is eliminated. Once capital expenditure and tax support sustainability are achieved, the capital reserve is gradually replenished to a healthy balance by 2027 through a stabilized sequence of declining tax increases that converges to inflationary levels.

The plan also addresses accumulated and arising pressures on the operating budget, including those that have been deferred from past years (e.g. removal of property reserve reliance), are essential to maintenance of service levels and avoidance of deficits (e.g. winter control infusion) or are simply unavoidable (e.g. WSIB insurance premium). These pressures can no longer be deferred and they cannot be ignored; they must be addressed, largely in 2018 and to some extent in 2019.

As such, substantial increases to operating tax support are required in 2018-2019 if service level expectations are to be met. The plan addresses the operating cost pressures by dramatically decreasing tax support for capital in 2018 and phasing in tax support sustainability from that decreased level. While this means achieving capital expenditure and tax support sustainability later than would otherwise be possible, it helps smooth the impact of the immediate operating pressures. Realistically, there is no choice but to address the operating pressures head on in 2018-2019.

<u>Water/Wastewater Portfolio</u>

Under the recommended 10-Year Financial Plan, capital expenditure, utility rate support and capital reserve sustainability are attained in 1 year, 6 years and 10 years, respectively, without the need for transitional debenture. This strategy is premised on collapsing the water and wastewater Infrastructure Levies into their respective fixed user fees. Since the 2017 infrastructure deficit is small enough that it can be considered within the natural range of variation from the average

sustainable expenditure, capital expenditure sustainability is achieved immediately.

Over time, the capital reserve is drawn down to facilitate the phase-in and stabilization of utility rate support increases. Once utility rate support sustainability is achieved, the capital reserve is gradually replenished to a healthy balance by 2027 through a stabilized sequence of declining utility rate increases that converges to inflationary levels. Largely due to the $5.8M Small Communities Fund grant awarded in 2016 for cast iron watermain replacement in Lindsay, the water/wastewater portfolio is much closer to sustainability than is the tax-supported portfolio.

Other Alternatives Considered:

For the tax-supported portfolio, one constraint is the amount of transitional debenture that is available and issuable within the applicable guidelines and the City's tolerance for debt. Another constraint is capital reserve integrity, whereby the reserve is to maintain a minimum balance of $1M and is to be replenished to a balance of at least $11.3M by 2027.

Among open and recently closed capital projects, Treasury Division has identified $40.7M worth of tax levy and reserve financing that could be replaced with debenture (see Appendix C). In conservative alignment with municipal debt guidelines and tolerance, only $25M of this amount is utilized in the plan. As a result, recommended tax increases are forecasted at 4.5%/annum for 2018-2021, 3.0%/annum for 2022-2023 and 2.0%/annum for 2024-2027.

Somewhat lower front end tax increases could be achieved with greater reliance on transitional debenture. Given the constraints of capital reserve integrity and significant 2018-2019 operating pressures, substantially more than $25M in transitional debenture would have to be issued to appreciably reduce forecasted front end tax increases. For instance, to reduce these to 4.0%/annum, the necessary issuance is estimated to be $42M.

As for the water/wastewater portfolio, the relevant constraint is capital reserve integrity, whereby the (combined water and wastewater) reserve is to maintain a minimum balance of $750K and is to be replenished to a balance of at least $2.9M by 2027. As a result, recommended combined water and wastewater utility rate increases are forecasted at 4.0%/annum for 2018-2020, 3.5%/annum for 2021-2022, 3.0%/annum for 2023-2024, 2.5%/annum for 2025-2026 and 2.0%/annum for 2027.

Other than considerably greater reliance on transitional debenture, the only available alternative to the above recommendations is a forecast that involves a slower elimination of the infrastructure deficit and/or insufficient long-term capital reserves. However, staff does not recommend such an alternative as it results in continuance of unacceptable service deficiencies and exposure to asset-related

risk, overreliance on transitional support from capital reserves, larger-than-otherwise tax/utility rate increases in the middle and latter part of the planning horizon and unacceptably low capital reserve balances in the long run.

Financial/Operation Impacts:

Please refer to the 10-Year Financial Plan, attached hereto as Appendix B, for details on forecasted financial impacts.

Relationship of Recommendation(s) To The 2016-2019 Strategic Plan:

This report is aligned with the strategic plan enablers: Responsible fiscal resource management and efficient infrastructure and asset management. The AMP and 10-Year Financial Plan are key elements of these enablers.

Review of Accessibility Implications of Any Development or Policy:

Components of the AMP address accessibility requirements of the City.

Attachments:

Appendix A: 2017 Asset Management Plan

Asset Management Plan - 2017.pdf

Appendix B: 10-Year Financial Plan

10-Year Financial Plan - 2018-2027.pdf

Appendix C: Capital Projects Eligible for Tax-Supported Debenture

Debenture-Eligible Capital Projects.pdf

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