Subject: Debt Strategy Update

Report to: Budget Review Committee of the Whole

Report date: Thursday, July 25, 2024

Recommendations

1. That this report **BE RECEIVED** for information.

Key Facts

- The purpose of this report is to provide Council with an update regarding recent discussions between Regional and Local Area Municipal (LAM) staff relating to current and future debt planning and strategy considerations.
- The objective of these discussions is to enhance collective debt planning and agree to adapt common strategies regarding capital project debt financing, in consideration of the Niagara Region's bond rating by Standard and Poor (S & P), Provincial Annual Repayment Limit (ARL) and Infrastructure Ontario Sector Limit.
- The Region and LAMs forecasted debt burden is expected to double over the next five years. The Region's forecasted debt issuance relates to previously approved capital projects, staff will not be recommending any new debt issuances in the shorter term.
- Staff will report back on discussions and recommendations annually in collaboration with LAMs.

Financial Considerations

The overall debt burden for the Region including LAMs is forecasted to double over the next five years. The increase in forecasted debt issuances is largely a result of infrastructure renewal needs. The Region's forecasted debt issuance relates to previously approved capital projects, staff will not be recommending any new debt issuances in the shorter term. The forecasted debt for LAMs has increased from last years meeting with S & P which could impact the Regions S & P bond rating this year. A reduction to our credit rating may result in less interest in our debt issuances from investors, which could then result in higher interest rates and increased debt costs.

The anticipated increase in the debt burden will also mean additional human resources will be required at the regional level in order to manage the debt portfolio as there is more administrative support required for more complicated debt instruments to support longer term debt outside of Infrastructure Ontario (IO), and to invest in stakeholder relations. We currently have less than 0.50 of an overall FTE supporting the debt portfolio.

Staff are also recommending introducing a second credit rating, which will allow us to attract a wider range of investors as some investors require two ratings. There is an additional cost to adding a second credit rating. Regional staff will be bringing forward a business case in the 2025 General Tax Levy Operating Budget in order to request an additional staffing position and funding for a secondary credit rating to support the debt program.

A longer-term option to reduce the overall debt burden over time is to increase the amount of funds being transferred to capital reserves each year from the operating budget, enabling more projects to be funded with reserves. However, moving to a more sustainable funding model for infrastructure replacement will result in an increase to the operating budgets for the General Tax Levy, Water and Wastewater Rates and Special Levies.

Analysis

Background

The Region's use of debt is guided by the Region's Capital Financing Policy which provides a strategy for establishing adequate levels of funding for capital projects that address sustainment, growth, and new strategic investments. The policy supports issuing debt for growth and strategic capital investments in an effort to be strategic within debt constraints while also ensuring that current property owners are paying for the sustainment of capital assets they are using, through annual operating budget transfers to capital reserves.

The Region issues debt on behalf of the LAMs in accordance with the Municipal Act. The Region accesses debt through two main sources, Capital Markets and Infrastructure Ontario (IO). There are also some other more specific debt sources such as Federation of Canadian Municipalities (FCM) and Tile Drainage loans that the Region also leads.

The Region is required to maintain a credit rating in order to issue debt on behalf of the Region and the LAMs. Currently this credit rating is provided by Standard & Poor's credit rating agency (S&P). In Fall of 2023, S & P confirmed the Regions AA+ stable credit rating based on six key rating factors, including the debt burden. The Region maintained our previous score for the debt burden based on our current year and two-year forecast planned debt issuances for both the Region and the LAMS. In discussions with S&P they noted that they are monitoring how our capital plan evolves and how we are managing the amount of debt we are taking on compared to revenue levels, which could impact our debt burden ranking and our S&P rating of AA+.

Debt is typically issued with IO for longer term debentures (20+ years) as there isn't typically interest from investors in the capital markets for large issuances of longer-term debt. The Region is subject to a "sector limit" with IO for debt issuances. In the fall of 2023, we were notified by IO that we were approaching our sector limit of $623 million, limiting the amount of IO debt that we will be able to access in the future. Given that we are approaching our sector limit we will need to be strategic and collaborate on how we prioritize capital projects for IO debt going forward.

Current State

As per Report CSD 17-2024, the anticipated Regional issued debt at the end of 2024 was $472.9 million and $391.6 million for the LAMs for a total of $864.5 million. Since the writing of that report, the requested amount of debt for 2024 has been reduced, it is now anticipated Regional issued debt at the end of 2024 will be $391.9 million and $378.6 million for the LAMs for a total of $770.5 million.

Incremental Infrastructure Ontario debt asks for 2024, included in Report CSD 17-2024 were $31.6 million, for a total amount of forecasted issued debt with IO of $577.1 million. Similar to above, since the writing of the report the requested amount of IO debt for 2024 has been reduced, it is now anticipated the incremental IO debt request for 2024 is $23.0M. This results in a remaining $55.0 million of our sector room of $623 million for future debt issuances with IO. Debt falling off each year is approximately $20 million which can also be used for incremental debt issuances.

Regional staff have discussed the current and future debt planning and strategy considerations with the Area Treasurers group on December 15, 2023, February 9, 2024, and March 22, 2024, in addition to a larger meeting with both the Area Treasurers and the CAO group on April 30, 2024. Staff recognize this will be an ongoing collaboration over the longer term.

Key discussion points in the meeting were around the need for the Region and LAMs to move towards sustainable funding models for infrastructure replacement impact, and the impact of our current and forecasted debt burden on our S & P bond rating.

Regional and LAM staff are working together to collect debt metric data and completing an environmental scan of all of our policies and practices related to capital investment and debt planning practices. This information will be reviewed collectively and determined how best to leverage on a go forward basis.

Debt Strategies Being Explored

1. Adequate transfers to Capital Reserves to fund pay-as-you-go capital projects: Ensuring adequate funds are approved in the annual base budget to sustain our capital replacement program going forward will reduce the amount of debt required to fund our capital programs. This also will allow for debt room to be available to support growth and strategic capital projects in alignment with the Capital Financing Policy.

2. Agreement on IO debt room allocations: Agreeing on how to allocate IO debt room based on debt terms (20+ years) and limiting the amount of capital projects with terms greater than 20 years will provide a way to allocate debt requests when there are more asks than debt room available. The IO sector limit constrains debt options for longer terms (for longer life assets). Other options exist for longer term debt, such as the capital markets, but come with higher administrative costs (if issuing debt through a sinking fund) or increased interest rate risk (for serial debt issuances with balloon payments).

3. Investing in Stakeholder Relations: Given the size of the forecasted debt, there is anticipated value in improving how we engage with the investment community and building relationships will help to garner more interest in investing in the Niagara Region. We are looking to our peers in Peel as an example in order to ensure there is enough interest in the market for future debentures issued through capital markets.

4. Collective Debt Planning: Investors are looking for predictable annual debt issuances. By working with the LAMs to smooth our debt asks and provide reliable forecasts each year we can present a more favourable debt model to stakeholders. Volatility in the amount of debt that we issue each year can impact marketability of the debt, resulting in less interest from investors and higher interest rates. This might result in the Region and/or the LAMs having to defer their debt issuance or issue debt earlier than anticipated. We will need to collectively investigate other options for shorter term debt options.

5. Asset Management Plan (AMP): The Province is requiring that we approve an AMP Financial Strategy. The AMP Financial strategy requires an update to include proposed level of service and financing strategy and must be approved and publicly available by July 1, 2025.

6. Continuing to support Policy Recommendations: Supporting the other common policy recommendations such as maintaining debt room for growth and/or strategic capital projects and budgeting for debt charges in the operating budget at the time the debt is approved will ensure debt is available for the appropriate capital projects.

Alternatives Reviewed

One alternative would be to restrict any further debt issuances until we can establish collective debt planning and adapt common strategies. This may limit the LAMs and Regions ability to deliver on capital projects.

Alternatively, the Region could also choose not to take action and investigate the debt strategies as outlined in the report. This is not recommended as it will risk the Region’s credit rating being downgraded, which will result in higher costs of debt and will negatively impact the ability to issue debt on behalf of the Region and LAMs.

Relationship to Council Strategic Priorities

This report aligns with Effective Region, delivery of fiscally responsible and sustainable core services.

Other Pertinent Reports

CSD 17-2024 Debt Information Report

(https://pub-niagararegion.escribemeetings.com/Meeting.aspx?Id=0ee64f91-8882-4a85-8e27-ed678e85744e&Agenda=Agenda&lang=English&Item=17&Tab=attachments)

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Appendices

Appendix 1 S & P 2023 Credit Rating Report