York Region

Clause 6 in Report No. 4 of Committee of the Whole was adopted, by the Council of The Regional Municipality of York at its meeting held on February 26, 2015, with the following amendment:

1. Council adopt the Fiscal Strategy outlined in this report as part of the 2015 Budget, *as adjusted to reflect the adopted 2015 Budget and the 2016-2018 Outlook*.

2. Council adopt the 2015 Long Term Debt Management Plan in Attachment 1 of this report, *as adjusted to reflect the adopted 2015 Budget and the 2016-2018 Outlook*.

2015 Regional Fiscal Strategy

Committee of the Whole recommends:

1. Receipt of the presentation by Bill Hughes, Commissioner of Finance.

2. Receipt of the presentation by Ed Hankins, Director, Treasury Office.

3. Referral of the report dated February 6, 2015 from the Commissioner of Finance and the following recommendations to Regional Council's meeting of February 26, 2015:

    1. Council adopt the Fiscal Strategy outlined in this report as part of the 2015 Budget; and

    2. Council adopt the 2015 Long-Term Debt Management Plan in Attachment 1 of this report.

1. Recommendations

It is recommended that:

1. Council adopt the Fiscal Strategy outlined in this report as part of the 2015 Budget;

2. Council adopt the 2015 Long-Term Debt Management Plan in Attachment 1 of this report.

2. Purpose

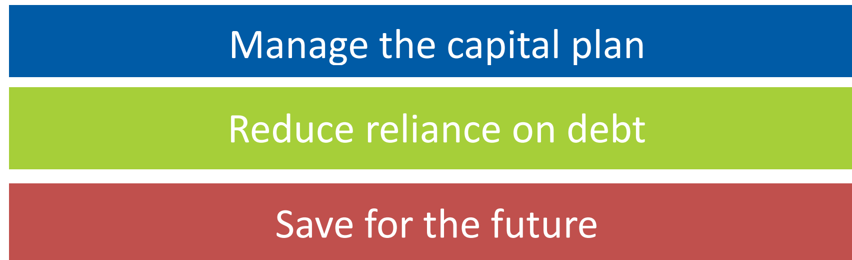
The report updates and reports upon the Regional Fiscal Strategy that was first adopted as part of the 2014 Budget. It also presents the 2015 Long-Term Debt Management Plan, which needs to be adopted or affirmed by Council in order to access the growth-related cost supplement to the Annual Repayment Limit (ARL).

3. Background

A formal fiscal strategy was first introduced as part of the 2014 Budget

The Regional Fiscal Strategy was formally introduced as part of the 2014 Budget. Its purpose is to better manage the financial resources of the corporation by considering the inter-relationships and integration needed between the capital plan, the debt management plan and the reserve management plan. It also deals with the long-term stewardship of capital assets – striking a prudent balance between the current and near-term investments and saving for the future.

Essence of the Fiscal Strategy



As a result of last year's Fiscal Strategy, a number of growth-related infrastructure projects were deferred in order to better match them with the revised development charge collection forecast. By realigning these projects, the 10-year Capital Plan in the 2014 Budget was reduced by $1.3B from $7.9B to $6.6B. Total development-charge-related debt for this period was reduced by $1B.

A new Debt Reduction Reserve was also approved. Based on forecasts contained in the 2014 Budget, it was estimated that over $400M of tax-levy debt could be avoided during the following ten years. To fund it, Council approved a policy to contribute between 50 per cent and 100 per cent of the debt servicing savings resulting from using this reserve to avoid issuing debt.

Council has a long established policy of putting money aside in reserves to pay for the future replacement of its major assets. In 2006, Council approved a policy to increase the annual contribution to the asset replacement reserves by an increment equal to one per cent of the prior year's tax levy. In 2013, Council amended this policy to gradually increase that increment by 0.2 per cent each year until it reaches two per cent of the prior year's tax levy in 2017. In 2014, the Fiscal Strategy re-affirmed this policy and included $61M in the Budget for this purpose.

As part of last year's Fiscal Strategy, the balances of the asset replacement reserves were also realigned to better reflect the amounts needed for each asset category. Furthermore, the authority to realign these balances in the future was delegated to the Commissioner of Finance. It was anticipated that the reserve balances and contribution levels would need to be updated again after the release of the State of Infrastructure Report expected in 2015.

Finally, the Fiscal Strategy included the closing and realignment of some reserves, as well as the establishment of new reserves to help manage the Region's financial resources more prudently.

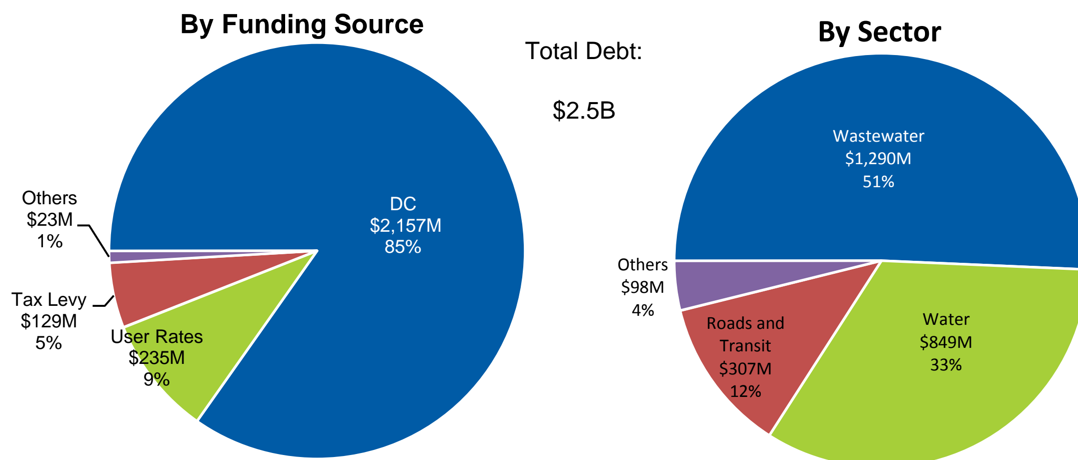
Previously projected debt levels were high due to the need to deliver major capital programs well ahead of the growth that would fund them

Historically, the Region has made very large investments in the infrastructure needed to service planned growth. Growth-related infrastructure projects are funded mainly through development charges that are collected over an extended period of time. Because of the economies of scale associated with building major projects such as water and wastewater and the long lead time required to complete them, they are usually constructed well in advance of the growth that will ultimately fund them. As a result, the Region uses debt to initially finance most growth-related infrastructure and then repays that debt when DCs are collected over time.

While the use of debt is necessary so that municipalities can grow, a practice of issuing too much debt too soon can significantly raise a municipality's exposure to future economic downturns.

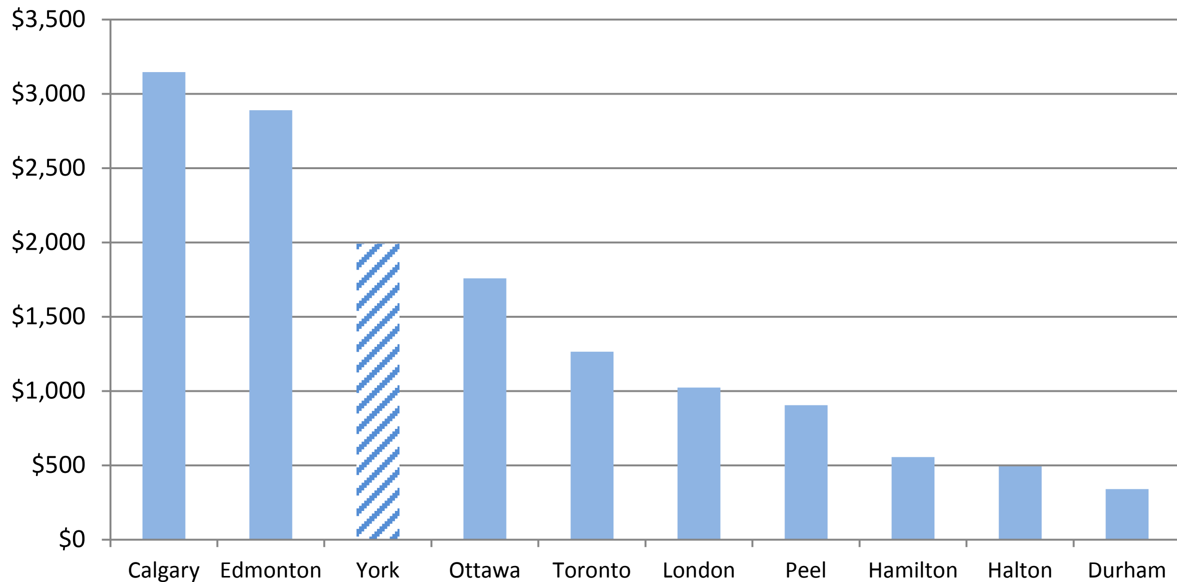
As shown in Graph 1, approximately 85 per cent of the Region's debt is growth-related and DC-funded, making the matching of the planned growth-related capital expenditure to actual growth very important.

Graph 1: Outstanding Debt – Region of York as at December 31, 2014



Source: York Region Finance Department

Note: Outstanding debt is estimated and subject to change as part of year-end adjustments



Source: York Region Finance Department

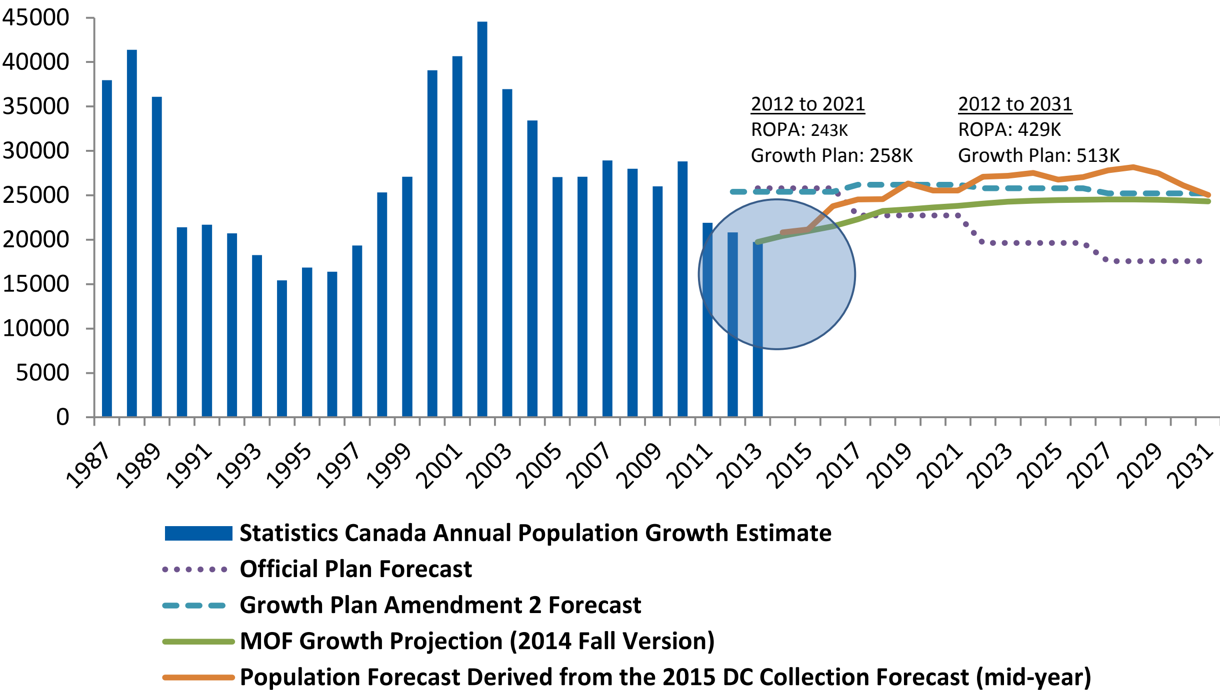
Graph 2 illustrates York's debt-per-capita relative to its peers, which is one of the metrics used by rating agencies when evaluating exposure to economic downturns.

Growth and DC collections continue to trend lower than originally forecasted, but are expected to recover over the medium and long term

The Region's population has been characterized by alternating periods of robust and more moderate growth (Graph 3). While the population continues to increase, the rate of growth has moderated significantly from the levels seen in the early 2000's. In recent years, York Region's population growth has been less than earlier forecasts.

Since 2011, the Region has been growing at an estimated rate of 22.8 thousand people per year, approximately 12 per cent less than the 2010 Official Plan forecast for the period 2011 to 2016.

Graph 3: Historic Annual Population Growth Estimate and Forecasted Annual Population Growth



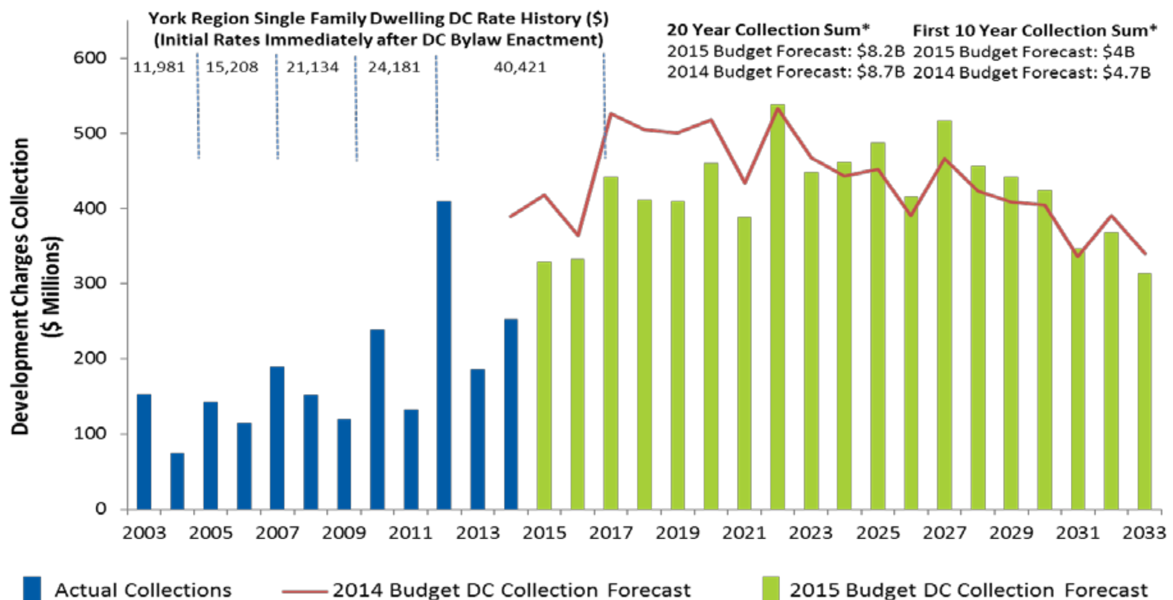
Development activities and population and employment growth are interrelated. Population changes, in particular growth in the adult population, spur household formation, which leads to demand for more housing. At the same time, a robust supply of housing provides opportunities for more people to settle in the region. Since the early 2000's, as the rate of population growth began to moderate in the Region, development activities also slowed. Average annual housing starts decreased from over 11,000 units per year in the early 2000s to approximately 8,500 units per year in 2010 (CMHC), and further slowed to approximately 7,500 units in 2013. Single and semi-detached homes have seen the most reduction in development activities over time, from a peak of over 9,300 units per year in 2002 to a low of approximately 3,500 units per year in 2013.

The DC collection forecast prepared for the 2014 Budget was based on the growth assumptions contained in the 2010 Official Plan and the 2012 DC Background Study, which projected 10 years of robust population and housing growth followed by 10 years of gradually slowing growth. It now appears that growth will not match this trajectory. The 2015 DC collection forecast reflects the observed trend in recent growth, with the expectation that growth will eventually pick up in the medium to long term. As a result:

- DC collections between 2014 and 2023 are forecasted to be $4B, approximately $643M less than last year's forecast.
- Collections between 2024 and 2033 are forecasted to be $4.2B, approximately $179M higher than last year's forecast.
- Over the 20-year period, forecasted collections will be down by approximately $464M.

The slower-than-anticipated housing growth over the near term means there is less DC revenue to repay debt, and results in a slower-than-expected build-up of DC reserves.

Graph 4: 20-Year Development Charge Collections Forecast Comparison of 2014 and 2015 Budgets



* The 20 year sum and the 10 year sum are shown for the 2014-2033 and 2014-2023 period respectively.

Source: York Region Finance Department

The 2015 Fiscal Strategy addresses the challenges posed by the slower-than-forecasted DC collections by continuing the measures adopted last year, as well as by implementing a number of additional corrective actions.

In 2014, Standard and Poor's noted the Region's greater exposure to market risk and lowered its credit rating by one notch

The Region's financial performance, in particular its ability to repay outstanding debt, is rated annually by both the Moody's Investor Service (Moody's) and the Standard and Poor's Rating Services (S&P). In the past, both agencies have recognized the Region's strong and sustained economic growth, exceptional levels of reserves and strong financial management as credit strengths that resulted in them assigning York their AAA rating. However, in 2014, while Moody's reaffirmed its "Aaa/Stable" rating of York Region's debentures, S&P lowered its rating by one notch from "AAA/Negative" to "AA+/Stable." In explaining the rationale for their changes, S&P noted that the Region's large growth-related capital spending requirements have now led to "very weak" budgetary performances, meaning that it has a high total operating and capital expenditures when compared to its operating revenues, as well as a "high" debt burden relative to other "AAA" rated municipalities. In S&P's opinion, these factors place York Region at greater risk in the event of an economic downturn.

The Region's current credit ratings remain superior and are consistent with the ratings of Canadian high growth municipalities such as Edmonton and Calgary. York Region's ratings are higher than Ontario, Quebec, Toronto and Montreal. While the downgrade has not had any impact so far on the Region's ability to obtain financing or its cost of new debt, further downgrades could result in an adverse outcome.

4. Analysis and Options

More growth-related capital projects have been deferred to better align with the latest growth forecast and to reduce the need for new debt

A key tenet of the Fiscal Strategy is to appropriately align the pace of large growth-related capital projects with the rate of population growth.

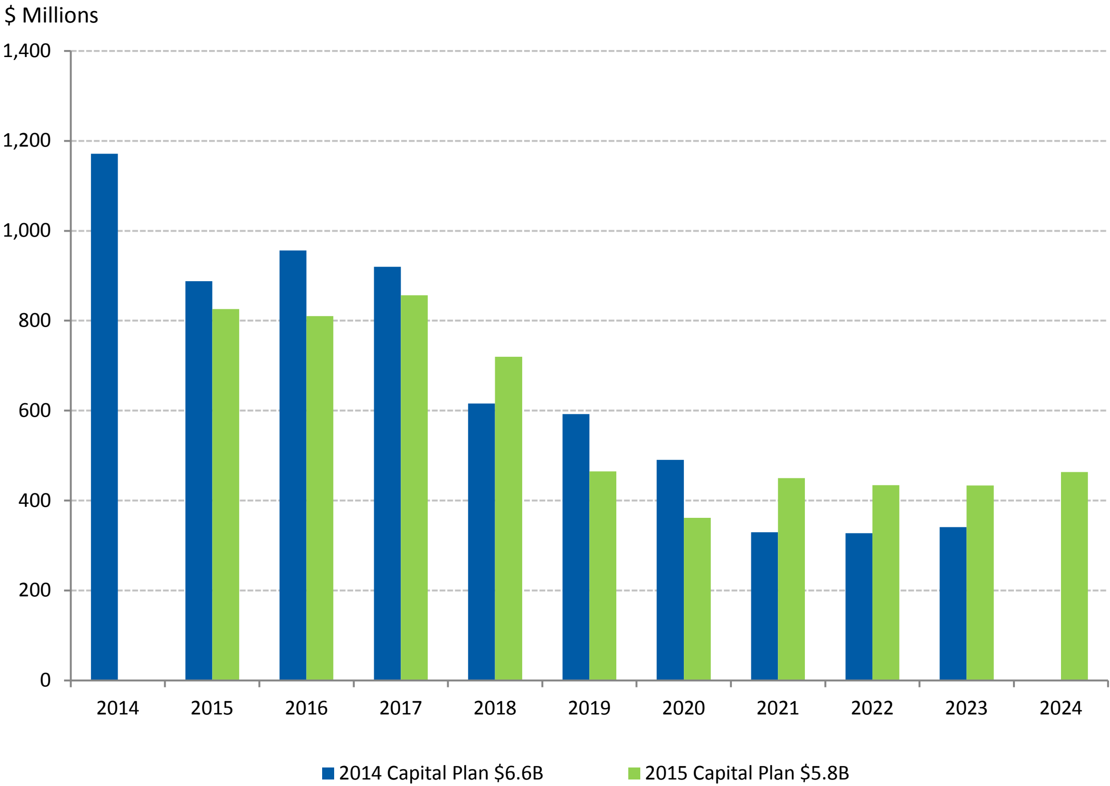
As noted earlier, the 2014 Budget shifted approximately $1.3B of expenditures from the 2014 to 2023 Capital Plan to periods beyond 2023. This was in a large part attributable to the concerted effort by departments to prioritize and defer capital projects while maintaining service levels.

In preparing the 2015 Budget, it was recognized that growth and the related development charge collections were continuing to slow and that the projected debt burden was still too high. As a result, further actions were undertaken to

better align the 10-year Capital Plan to expected growth by adjusting it down by $0.8B from a planned $6.6B to $5.8B. To achieve this reduction, some water and wastewater projects are being deferred.

It should be noted that the 10-year Capital Plan protects the planning and design work for the deferred projects to ensure they are ready for construction once growth occurs. Should DC collections recover sooner than expected, the Capital Plan could also be adjusted in the future to deliver the deferred capital projects earlier. These measures will help ensure that future capital projects are cost-effective and minimize required borrowing, while continuing to support growth.

Graph 5: 10-Year Capital Plan Comparison of 2014 and 2015



Source: York Region Capital Budget

A balanced approach to debt and reserve management is crucial to the Region's fiscal health

While the realigned 10-year Capital Plan has deferred some investment, the forecasted amount being spent is still close to the highest among the 905 regions.

In order for the Region to prudently manage its infrastructure needs, it is crucial that it adopt an integrated and sustainable fiscal strategy, one that seeks to reduce heavy reliance on debt by appropriately increasing the use of reserves.

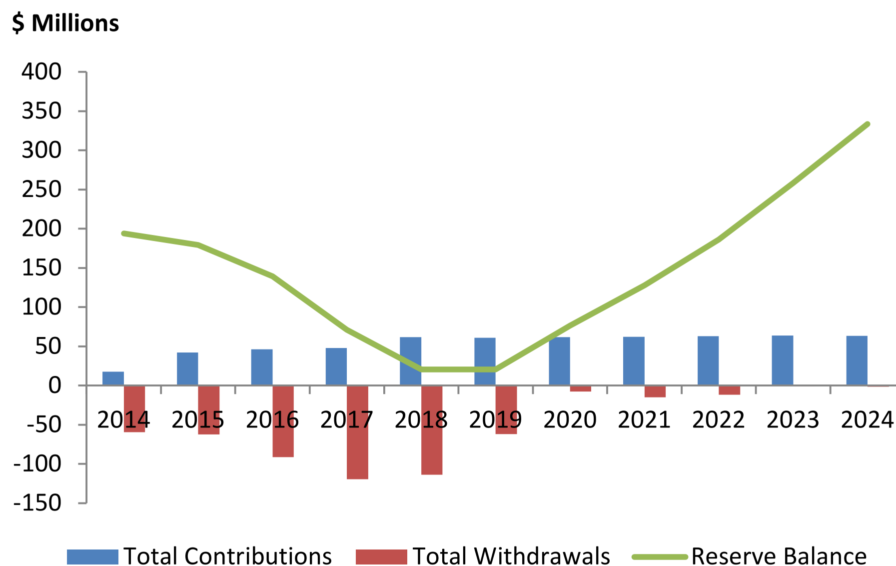
Contributions to the Debt Reduction Reserve will avoid the need for future tax-levy debt during the forecast period

As noted earlier, a new Debt Reduction Reserve was created as part of the 2014 Budget to reduce or eliminate the need to issue previously approved tax-levy debt.

In addition to the approximately $400M of debt avoided shown in the 2014 Budget, staff have also identified opportunities for further reducing tax-levy funded debt through the use of Federal Gas Tax funding for waste management and rapid transit projects. As a result, there will not be any need for additional tax-supported debt over the next 10-years.

Unless new tax-levy funded projects are identified in future budgets, the balance in the Debt Reduction Reserve is projected to grow after 2019 (Graph 6), and may provide the Region with an opportunity to examine alternate uses for the reserve at that time. This could include further increases in asset replacement reserves, depending on the needs identified in the asset management plans currently under development.

Graph 6: Growth in Debt Reduction Reserve



Source: York Region Finance Department

A reduction of $1.3B in debt over the next ten years was achieved through capital deferrals and optimization of DC reserves

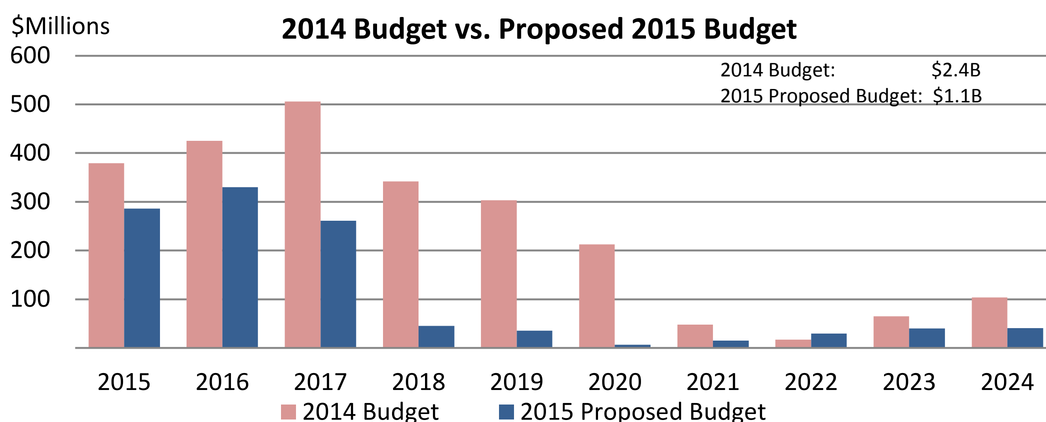
The Region has a policy of maintaining a minimum of one year's principal and interest payments in the DC reserves. The policy provides assurance to bond holders and credit rating agencies that the Region will be able to service its debt.

However, the DC reserves frequently have more than this amount in them. As part of the 2015 Fiscal Strategy, the Region plans to optimize the use of these excess DC reserves, meaning that amounts above the one year principal and interest threshold will be used to pay directly for growth-related infrastructure, instead of issuing DC debt.

Based on the current projection of DC collections, the optimization approach, coupled with the $0.8B capital deferrals, will allow the Region to avoid about $1.3B in debt over the next ten years (Graph 7).

The amount of DC debt that can be avoided through this optimization strategy is contingent upon the DC reserve levels and therefore DC collections. While the analysis has taken into consideration some contingencies, staff will continue to closely monitor the Region's economic and development activities, as well as DC collections to ensure the DC reserves are fully optimized without adversely affecting liquidity.

Graph 7: Debt Needs Reduced Through Capital Budget Realignment and Optimizing the Use of Reserves

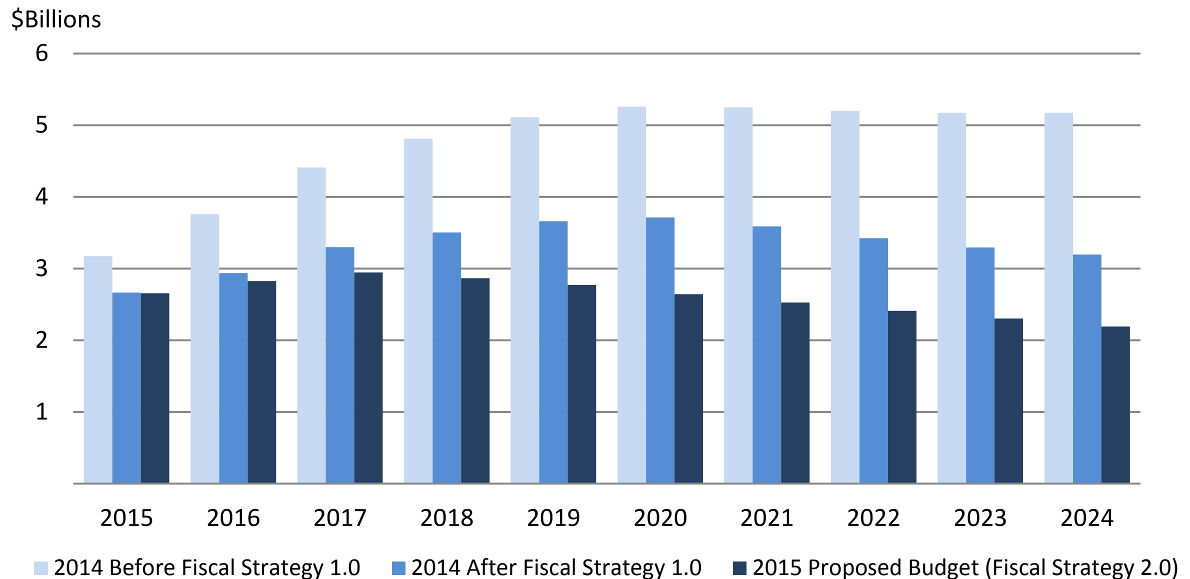


Source: York Region Finance Department

Outstanding debt is now expected to peak at $0.8B less than previously forecast in 2014

The Region will continue to use debt to meet some of its infrastructure needs. As a result of all the above measures, the Region's requirements for new debt over the next ten years have been reduced from $2.4B to $1.1B and expected peak debt has been reduced by $0.8B from $3.7B in 2020 to $2.9B in 2017 (Graph 8).

Graph 8: Outstanding Debt Projection



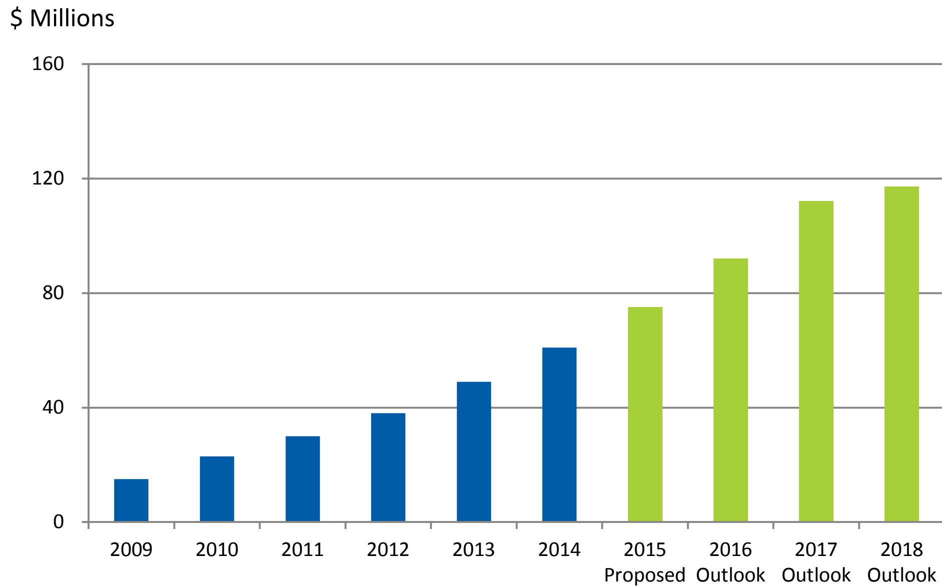
Source: York Region Finance Department

By providing for asset replacement now the Region can avoid the need to issue debt in the future

The 2015 Budget emphasizes the need to provide for future replacement of capital assets as an element of prudent fiscal planning. Asset management planning ensures that assets can be operated and maintained to provide the desired level of service and avoid premature failures. The financial corollary of asset management planning is that funds need to be in place for replacement, rehabilitation and upgrades when needed.

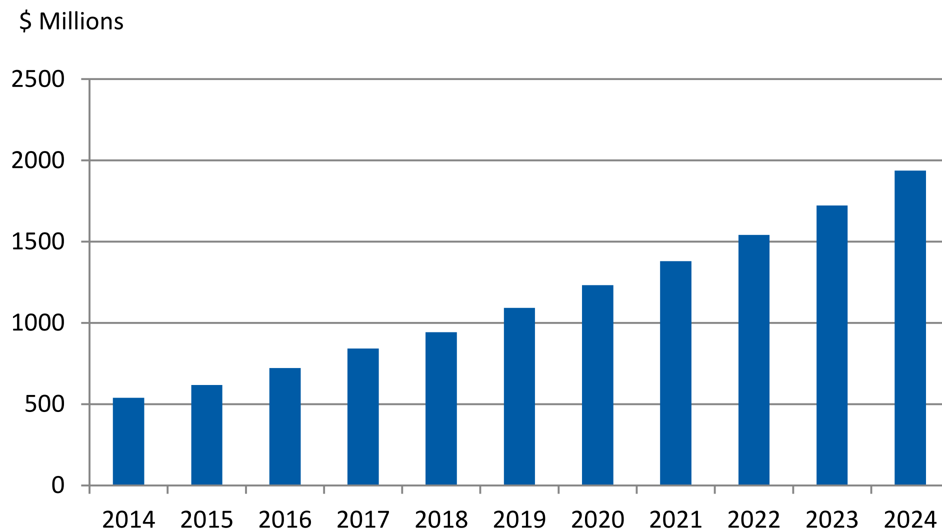
Council's current policy of funding replacement reserves will result in $75M being contributed to the corporate capital asset replacement reserve in 2015. Graphs 9 and 10 show the projected contributions to the asset replacement reserves and the growth in replacement reserves over the next 10 years.

Graph 9: Annual Contribution to Corporate Asset Replacement Reserves



Source: York Region Finance Department

Graph 10: Forecasted Capital Asset Replacement Reserve Balances



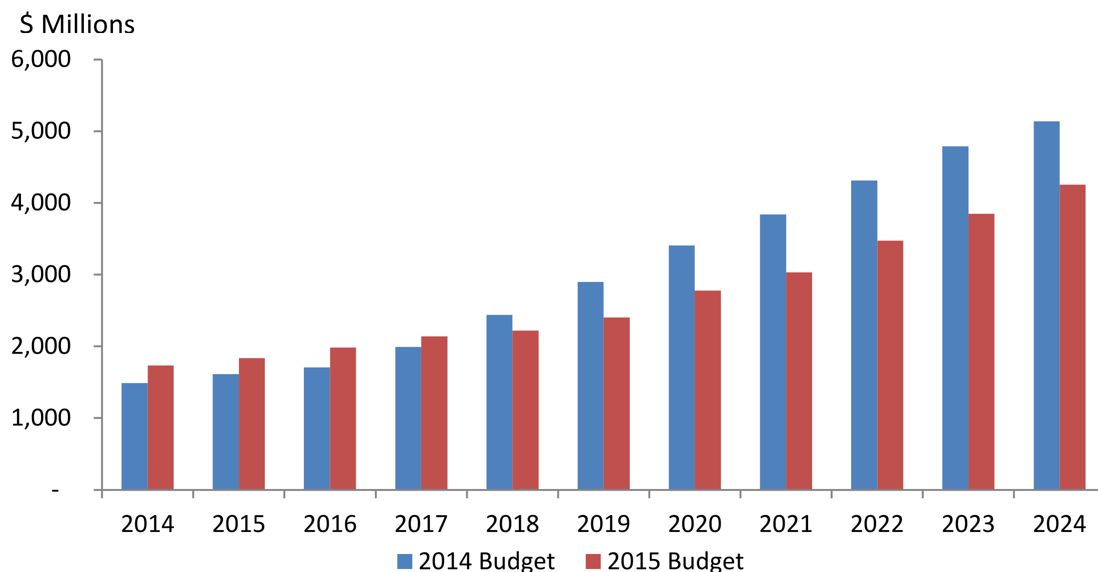
Source: York Region Finance Department

Reserve projections are still on target

Maintaining sufficient reserves is a key element of the Region's Fiscal Strategy, as they provide flexibility for significant unanticipated expenditures, allow for the replacement of assets without a major impact to the tax levy, and supply funds for new capital assets. In addition, because reserves are liquid – that is, they are made up of cash and assets turned into cash relatively easily – they promote investor confidence. As part of its strong financial management, York Region will continue to maintain and build reserves, with a special emphasis on building reserves for asset replacement and debt reduction. Current projections show that there will be an increase of $2.5B in the Region's reserve levels over the next ten years.

As shown in Graph 11, the 2015 reserve projection is close to the 2014 projection, except where some funds have been redeployed to avoid DC debt through the DC reserve optimization strategy described earlier. While the Region's need for new debt will be reduced by $1.3B over the next 10 years, the reserve balance in 2024 will be only approximately $885M lower than the 2014 forecast.

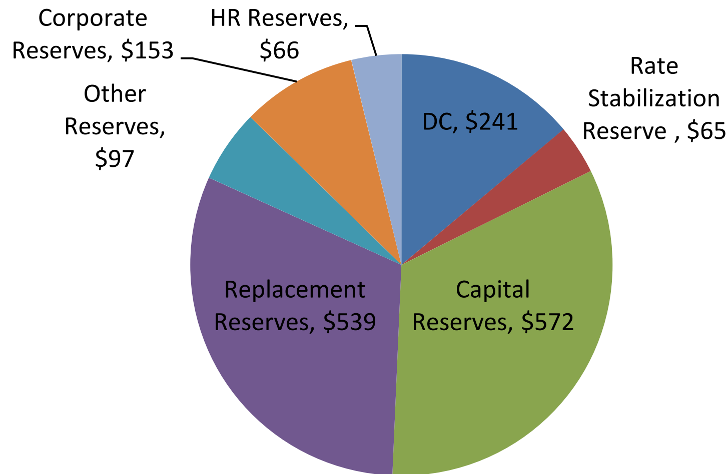
Graph 11: Total Reserves



Source: York Region Finance Department

Graph 12 shows the composition of the Region's reserves, which include over $500M for asset replacement.

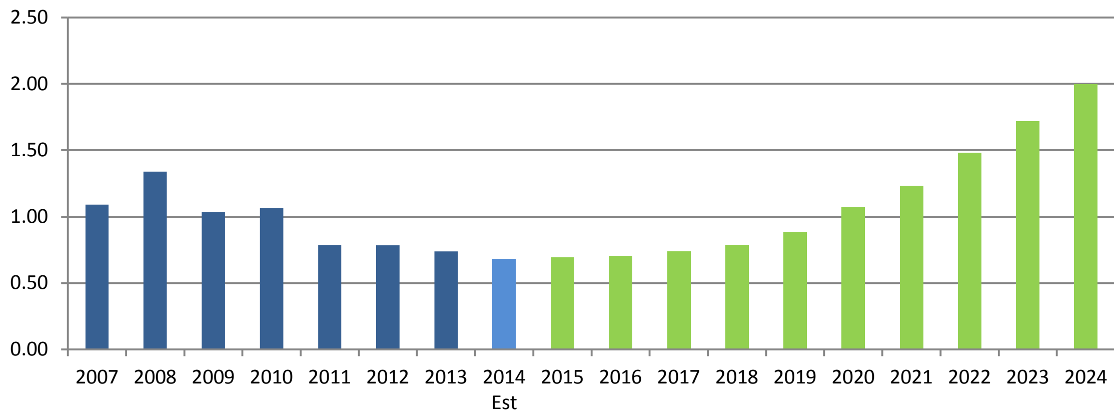
Graph 12: Composition of Reserves: $1.73B Estimate as at December 31, 2014 ($ Millions)



Source: York Region Finance Department

With peak debt lowered and a commitment to building reserves, York Region should expect to see a strong improvement in its ratio of reserves to debt. In fact, it is expected that the Region will become a net investor again by 2020, as shown in Graph 13.

Graph 13: Reserve to Debt Ratios



Source: York Region Finance Department

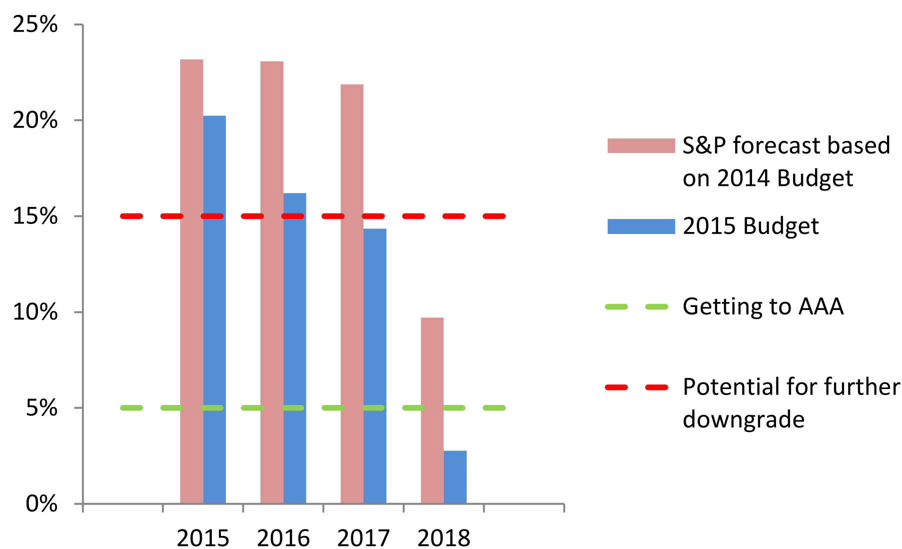
Proposed measures should put the Region on the path back to a triple "A" credit rating

The Region's current credit ratings are still among the highest of all high growth municipalities in Canada. In addition, the 2015 Fiscal Strategy will help address the concerns raised by S&P in 2014.

First, the "very weak" budgetary performance cited for York Region will be significantly improved as planned capital expenditures are reduced over the next four years to a level more consistent with other AAA rated municipalities. Second, by aligning new capital expenditures with expected DC collections and the greater use of reserves, the need for new debt will also be reduced with the result that the debt burden ratio will move closer to S&P's AAA level.

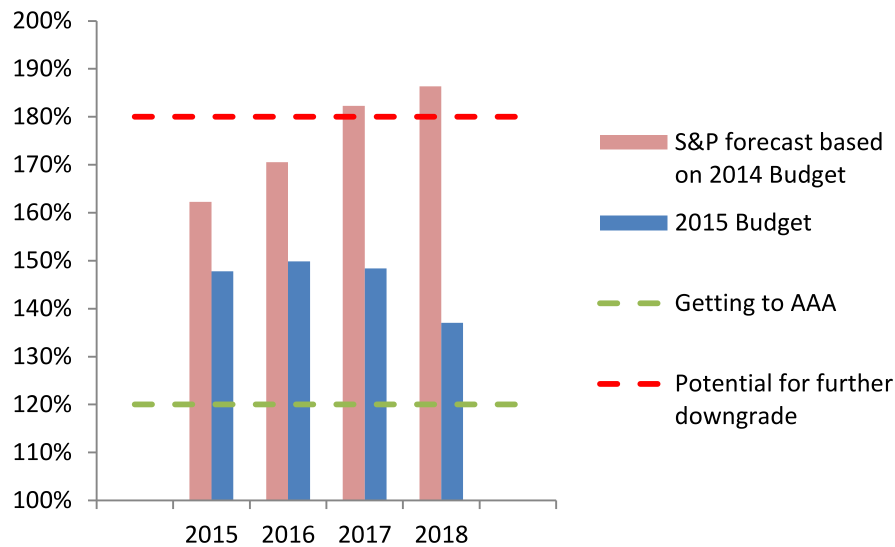
The key ratios that were identified by S&P (based on the 2014 Budget) are shown on Graphs 14 and 15, together with comparable ratios prepared using information from the 2015 Budget.

Graph 14: Budgetary Performance Ratio – Deficit after Capital Expenditure/Total Revenue



Sources: S&P's forecast and York Region 2015 Budget

Graph 15: Debt Burden Ratio – Outstanding Debt/Operating Revenue



Sources: S&P's forecast and York Region 2015 Budget

Council needs to adopt or affirm a 2015 Long-Term Debt Management Plan

The amount of municipal debt and other financial obligations that a municipal council can authorize is determined by the Annual Repayment Limit (ARL) regulation under the Municipal Act, 2001. In 2010, the Province recognized that York Region was a high growth municipality with special debt needs, and provided it with a specific regulation that allows it to borrow a higher amount that would be funded through development charges. To qualify for this additional growth-related borrowing supplement, Council is required to adopt or affirm a plan each year for the management of its long-term debt and financial obligations. The 2015 proposed Long-Term Debt Management Plan is attached to this report (Attachment 1).

Link to key Council-approved plans

One of the Strategic Priority Areas of the Region's 2015-2019 Strategic Plan is to provide responsive and efficient public service, which encompasses the objectives to ensure a fiscally prudent and efficient Region and stewardship of the Region's assets. This Fiscal Strategy directly supports these objectives, as it provides an integrated approach to funding the Region's Capital Plan.

5. Financial Implications

The 2015 Regional Fiscal Strategy reduces the 10-year Capital Plan by $0.8B, reduces the need for new debt by $1.3B in the next ten years, and lowers the peak debt level by $0.8B from $3.7B to $2.9B.

6. Local Municipal Impact

Local municipalities will benefit from the Region's Fiscal Strategy, as all municipalities will benefit from good financial management and lower debt.

The Fiscal Strategy relies on collecting development charges for growth that take advantage of the water and wastewater infrastructure that has already been built or will be built as part of the revised ten year capital plan. All municipalities in the Region will be able to continue to grow with the available capacity for at least seven years. Growth in specific areas may be temporarily delayed as a result of capital deferrals.

7. Conclusion

The Regional Fiscal Strategy is an evolving strategy to better manage the financial resources of the corporation by integrating the capital plan with anticipated funding sources, reducing the reliance on debt and building reserves while still meeting the needs of a growing population.

In 2014, the Fiscal Strategy focused on the need to defer some capital projects, continue to build reserves for the future replacement of capital assets, and reduce reliance on tax levy debt through the establishment of a Debt Reduction Reserve.

For 2015, recognizing that development charges are still expected to be lower than originally forecast in the near future, the 10-year Capital Plan was again adjusted to more closely match the timing of growth and the expected collection of development charges. Tax levy debt has been completely eliminated over the forecast period, as it is now anticipated that all tax-levy-debt projects will be able to be funded through the Debt Reduction Reserve. The need for new DC debt was also significantly reduced by optimizing the use of DC Reserves.

For more information on this report, please contact Edward Hankins, Director, Treasury Office, at ext. 71644.

The Senior Management Group has reviewed this report.

February 6, 2015

Attachments (1)

Accessible formats or communication supports are available upon request

Attachment 1

2015 Long-Term Debt Management Plan

Introduction

Municipalities in Ontario may only issue debt for capital purposes. The Province regulates the amount of municipal debt and other financial obligations through an Annual Repayment Limit (ARL) regulation under the *Municipal Act*. The ARL limits the aggregate annual cost of servicing the anticipated long-term debt and financial obligations to 25 per cent of a municipality's own source revenue plus, in the case of York Region alone, a growth cost supplement equal to 80 per cent of the average of the Region's last three fiscal years of Development Charge (DC) collections. The combination of the ARL and the growth cost supplement is called the Growth-Related ARL, but will be referred to as the ARL in this plan.

To qualify for the growth-related cost supplement, the Region is required to meet two conditions:

1. Maintain at least an AA low (or equivalent) credit rating; and

2. As part of the preparation of its budget for the fiscal year, Council adopts or affirms a plan for the management of its long-term debt and financial obligations.

As of December 2014, the Region had met the first condition by maintaining an Aaa credit rating with Moody's Investor Service and receiving a AA+[1] credit rating from Standard and Poor's Rating Services.

To meet the second condition, the Province requires Regional Council to consider the following items as part of its long-term debt management plan:

1. The Region's needs for its long-term debt and financial obligations over a multi-year period;

2. Projections of the ARL for each year of the multi-year period compared to its existing and proposed long-term debt-related payments;

3. Risk and mitigation strategies associated with the Region's long-term debt strategy;

4. Long-term debt and financial obligations policy;

5. Prudent and cost-effective management of existing and projected long-term debt and other financial obligations;

6. Estimated temporary borrowing needs for 2015; and

7. Evaluation and comparison of 2014 projections and outcomes.

[1] On July 31, 2014, Standard and Poor's Rating Services downgraded the Region's credit rating to AA+ from AAA, a rating that the Region had held for the past 13 years in a row.

2015 Long-Term Debt Management Plan

1. The Region's Needs for its Long-Term Debt and Financial Obligations Over a Multi-Year Period

Regional Fiscal Strategy adopted in 2014 used in preparing 2015 Budget

In preparing the 2015 Budget, staff continue to follow the fiscal strategy that was formally adopted by Council in 2014 in order to better manage the Region's financial resources. A major tenet of this strategy was to use a more balanced approach to funding long-term capital expenditures. To accomplish this, detailed reviews of both forecasted expenditures and new funding sources must be undertaken each year by departmental staff from across the Region. As part of this review, the DC collection forecast for 2014 was reduced to reflect the recent observed slowing trend in population growth. It was also determined that certain capital expenditures could be deferred into later periods without adversely affecting the Region's ability to continue to grow. As a result, the 2015 10 year capital plan is approximately $0.8 billion less than the 2014 forecast. In addition, the use of the tax-levy Debt Reduction Reserve will continue to avoid the need for issuing new debt where cash funds in reserves can be used instead. As a result of all of these fiscal measures, anticipated debt needs have been significantly reduced from the 2014 forecast.

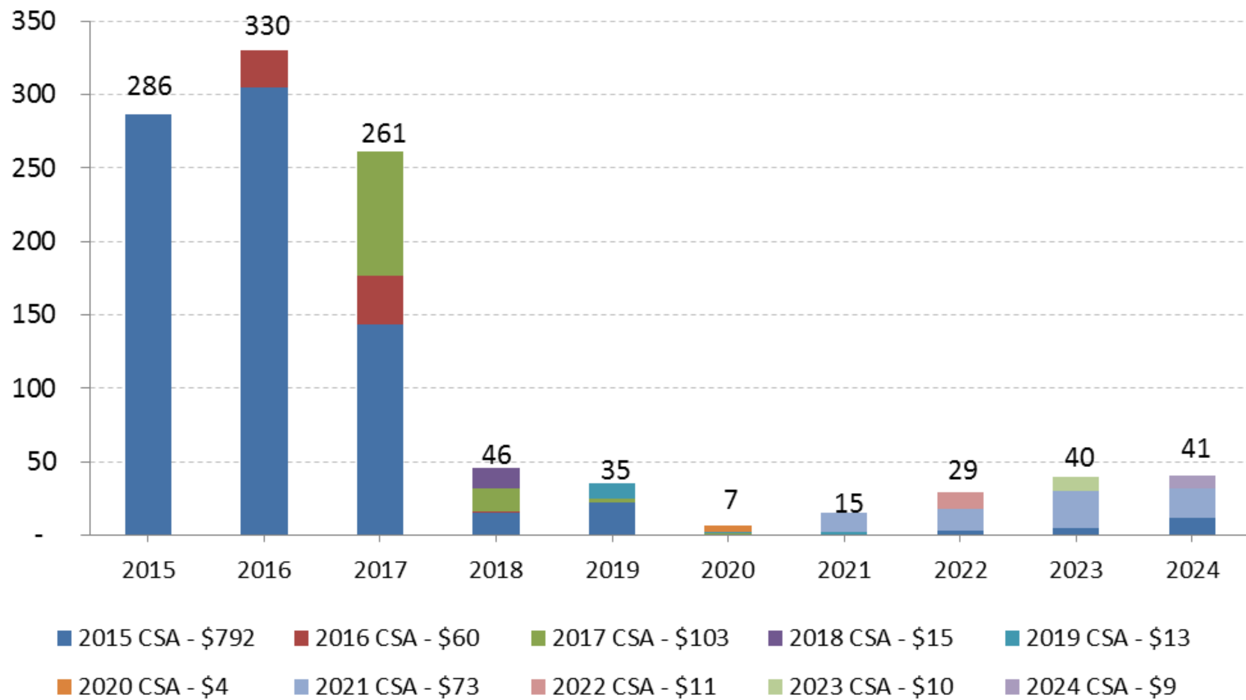
The Region's reliance on debt to finance its capital plan has decreased significantly

The 2015 Capital Plan shows a capital expenditure projection totaling approximately $5.8 billion over the 2015-2024 forecast period. Of this, approximately $1.1 billion will be funded from debenture proceeds, for a debt funding ratio of 19 per cent. This compares to a debt funding ratio of 43 per cent anticipated for the same period in the 2014 capital plan. Approximately $0.8 billion of the $1.1 billion in projected debenture requirements is included within the Capital Spending Authority (CSA) for 2015, as illustrated in Chart 1.

Capital Spending Authority provides Council's authorization for departments to proceed with capital projects, including multi-year projects. The Region must have enough debt room when Capital Spending Authority is approved to remain within its provincially-mandated Annual Repayment Limit (ARL).

The Region's capital plan also contains projects with an estimated debt of about $0.3 billion that are planned, but do not yet have Capital Spending Authority. For the purposes of this Debt Management Plan, departments have estimated the Region's future debt requirements for each year of the plan on a CSA basis. This will be described in further detail below.

Chart 1
Multi-Year Forecast of $1.1 Billion New Debt to be Issued
2015-2024
($Millions)



Source: York Region Finance Department

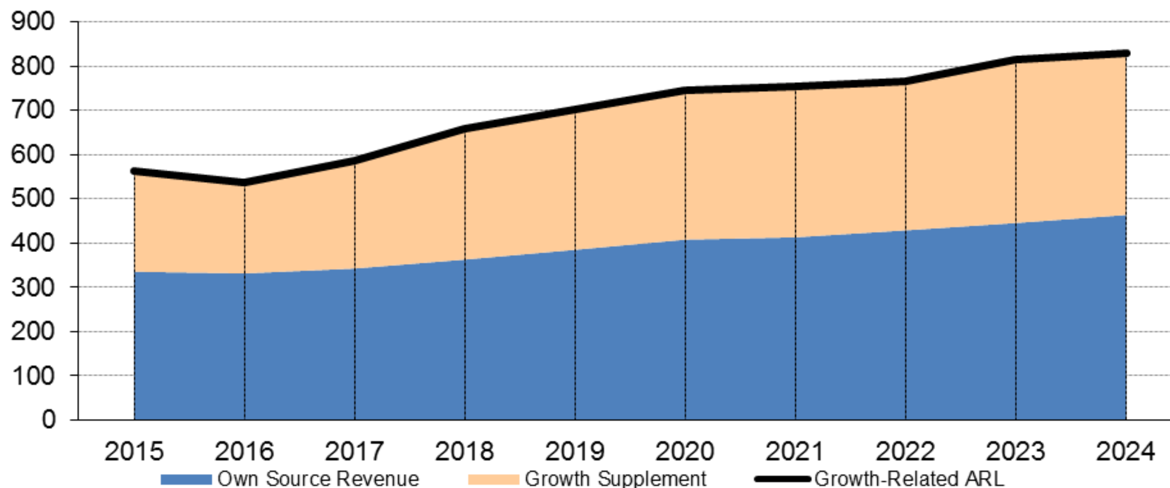
2. Projections of the ARL for Each Year of the Multi-Year Period Compared to Existing and Proposed Long-Term Debt-Related Payments

How much debt room will we have?

The ARL is calculated by determining and projecting 25 per cent of the Region's own-source revenues, and adding 80 per cent of the three-year rolling average of historic development charge collections (derived from the development charge collection forecast). The Region's existing and proposed annual financial obligations must be within this limit. These calculations are shown in Appendix 1.

Based on these calculations, the Region's ARL will increase from $562 million in 2015 to $830 million by 2024, as illustrated in Chart 2 below:

Chart 2
Annual Repayment Limit Forecast
2015-2024
($Millions)



Source: York Region Finance Department

What are our estimated debt and financial obligation payments?

The existing debt payment and financial obligations include the following components:

- Principal Obligations
- Interest Obligations
- Social Housing Mortgages
- Long-term Leases
- Hospital Funding.

These existing annual debt payment and financial obligations will total approximately $299 million in 2015, but are estimated to decline to $221 million by 2024. The largest component of these obligations will be the principal and interest on existing debt, which is expected to decrease from $270 million in 2015 to $190 million by 2024 as existing debt is repaid. Hospital financing is forecast to increase at a rate of 2 per cent per year, rising from $13.4 million in 2015 to $15.9 million by 2024.

As noted earlier, the Capital Spending Authority budgeting concept employed by the Region requires that there be enough debt room under the ARL at the time of project authorization. For example, in order to assign CSA to projects as part of the 2015 budget process, the Region must have sufficient room under its 2015 ARL to recognize the full financial cost of the projects "as if" they were going to be incurred entirely in 2015, even if the actual costs are spread out over multiple years. This is the case for each year of the capital plan.

2015 Long-Term Debt Management Plan

The Capital Spending Authority in the 2015 Budget is $2.3 billion, of which $0.8 billion will be debt financed. Assuming an annual interest rate of 5.00 per cent in 2015 and a term of 20 years, the annual obligation arising from this debt for 2015 will be approximately $65 million.[2]

Will the Region be within its ARL?

For 2015, the Region will be within its ARL, as shown in Table 1 below.

Table 1
Region's 2015 ARL Calculation
($Millions)

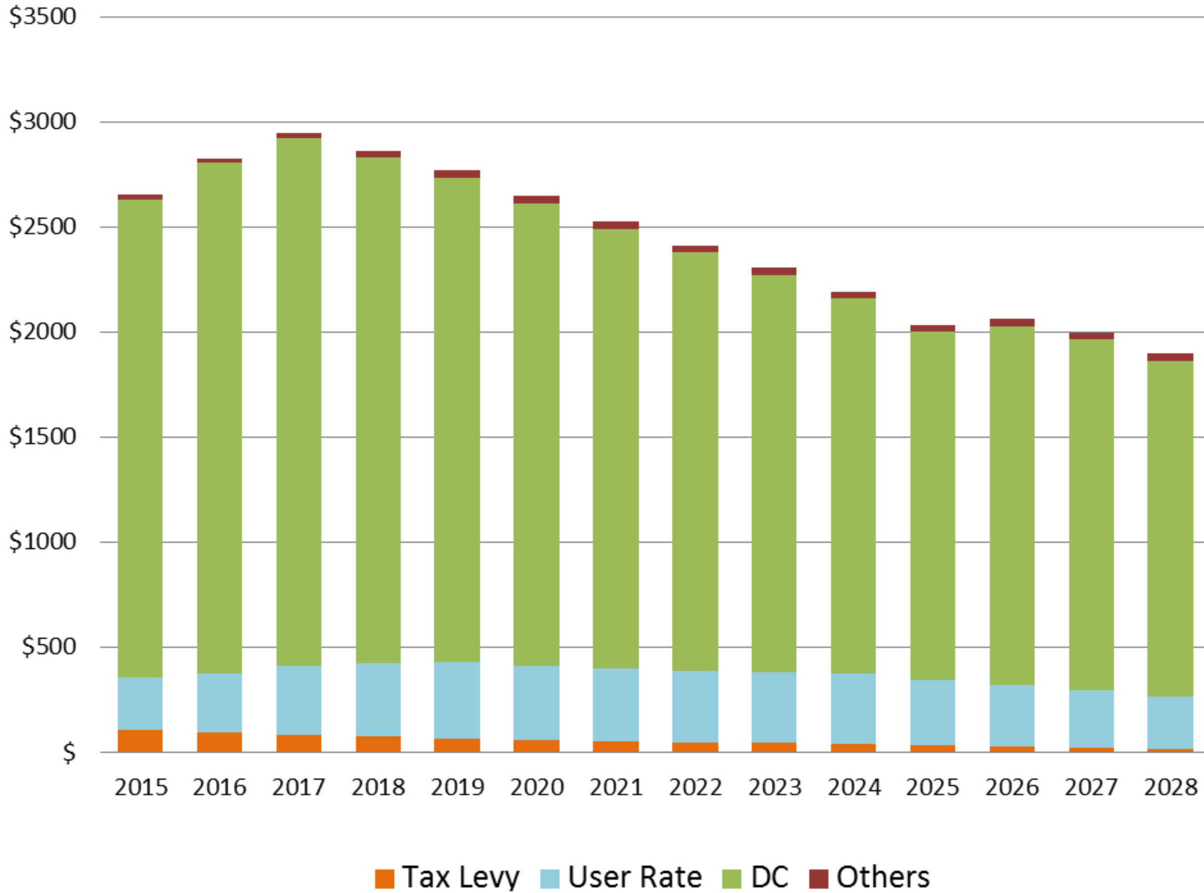
Component Description	Forecast 2015
25% of Own Source Revenues	335
Plus: Growth Cost Supplement[1]	226
Total ARL	**561**
Less: Existing Debt Payment and Financial Obligations	299
Less: Anticipated New Debt Payment	65
Remaining ARL	**197**

1. Growth Cost Supplement in 2015 is calculated at 80 per cent of the 3-year rolling average of Development Charge collections (2012-2014 inclusive)

To replicate this calculation over a multi-year period, future CSA has been estimated based on the anticipated timing of future project commitments. While debt authorities will not be carried forward from one year to the next, it is assumed that the amount of debt authorized in 2015 will form the "base" for the debt request to be authorized in subsequent years. Assuming that the debt needs remain as shown in the ten-year capital budget and all future CSA debt occurs as planned, the Region's outstanding debt will increase from $2.7 billion in 2015 to a high of just over $2.9 billion in 2017 and then start to decrease in 2018, as illustrated in Chart 3.

[2] This is the weighted average interest rate based on a review of current and historic rates as well as planned CSA cash flow timing. The 20-year term is based on the anticipated average term of future debt issues. Debt repayment is calculated on a "full commitment basis", which allocates a full year's payment to the year of issuance rather than the partial (i.e., interest only) payment that usually occurs as a result of issuance timing.

Chart 3
Outstanding Debt Projection
2015 to 2029
($Millions)



Source: York Region Finance Department

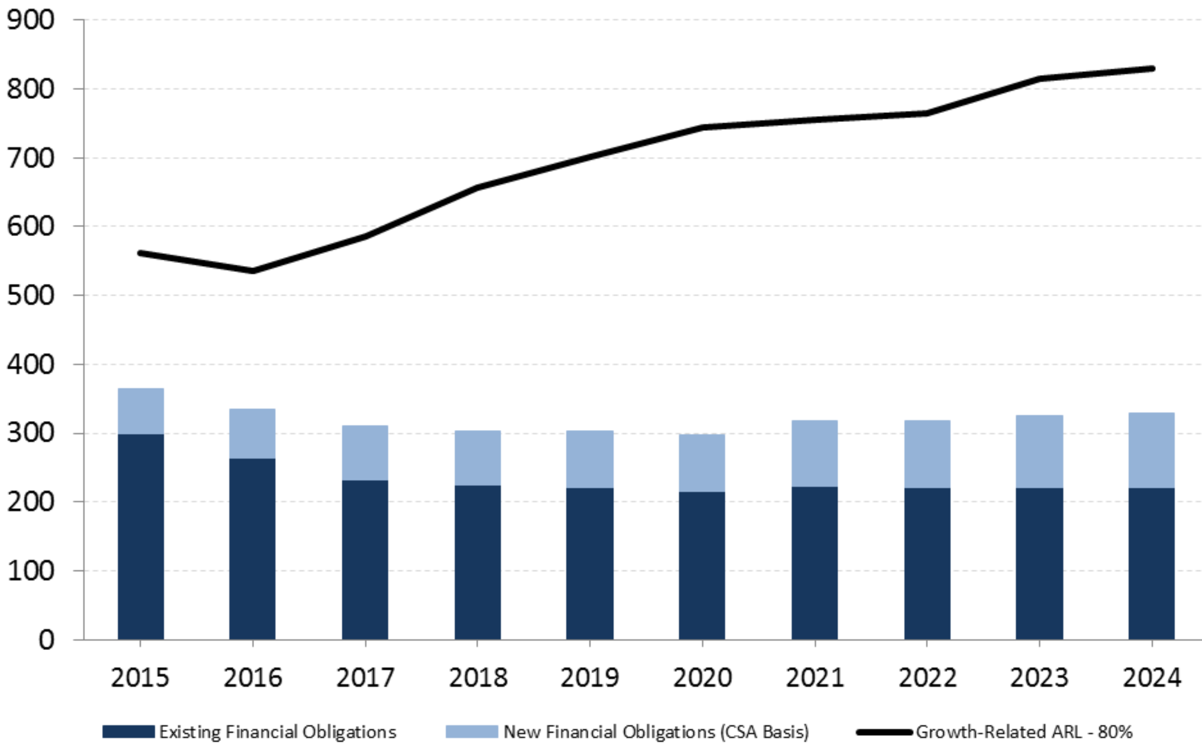
The annual debt payments related to each year's increment have been calculated on the same basis as the 2015 CSA, except that the assumed interest rate will increase to 6.50 per cent by 2024.[3] As a result, the financial obligations associated with new debt-related CSA will increase to $109 million by 2024.

Chart 4 shows that the Region's financial obligations will be well within its ARL for all years.

[3] The base rate assumptions increase from 5.00 per cent to 6.50 per cent by 2024 and are held constant thereafter. The term will remain 20 years and the payment will continue to be calculated on a "full commitment" basis for the entire forecast.

2015 Long-Term Debt Management Plan

Chart 4
Annual Repayment Limit vs.
Annual CSA Based Debt and Financial Obligations
2015-2024
($Millions)



Source: York Region Finance Department

3. Risk and Mitigation Strategies Associated with the Region's Long-Term Debt Strategy, Including Interest Rate Risk and Foreign Currency Exposure

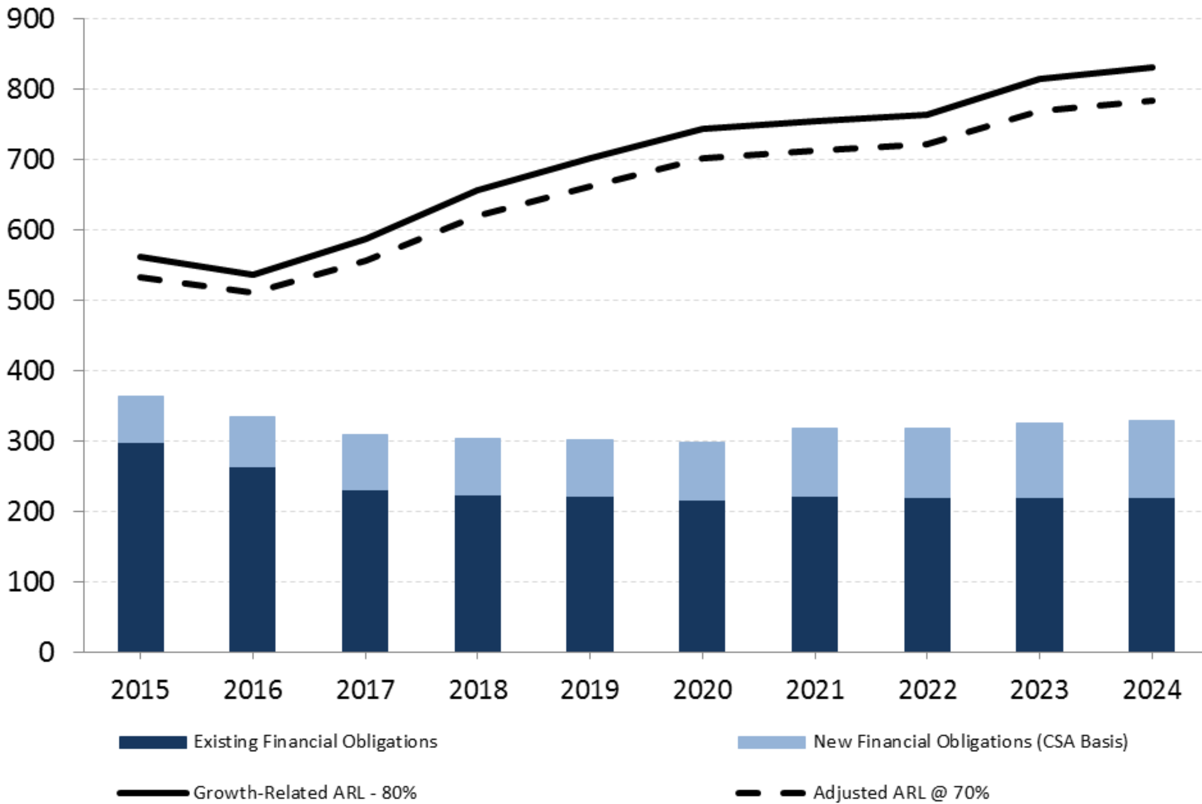
Anticipated development charge collections represent one of the most significant risks to remaining within the ARL

Development charge collections are difficult to predict from one year to the next and can vary significantly as economic conditions change over time. Lower-than-forecast DC collections could limit the Region's debt issuing abilities to levels below those indicated in this plan and require changes in the phasing of the capital plan. Staff periodically reviews DC collection trends and forecasts to enable further changes before finalization of the capital plan.

As a matter of normal practice, the Region's capital plan will be measured against an adjusted ARL that uses only 70 per cent of the three-year rolling average of historic DC collections as a cost supplement, versus the 80 per cent permitted, unless specific Council approval is obtained to do otherwise. This would have the effect of partially mitigating the impact of lower-than-expected DC collections. The impact on the ARL calculations of the adjusted ARL that uses

only 70 per cent of the three-year rolling average of historic DC collections as a cost supplement is illustrated in Chart 5, which shows that the Region's obligations would still be well within its ARL even if only 70 per cent of forecast DC collections are considered as a cost supplement.

Chart 5
Adjusted Annual Repayment Limit vs.
Annual CSA Based Debt and Financial Obligations
2014-2023
($Millions)



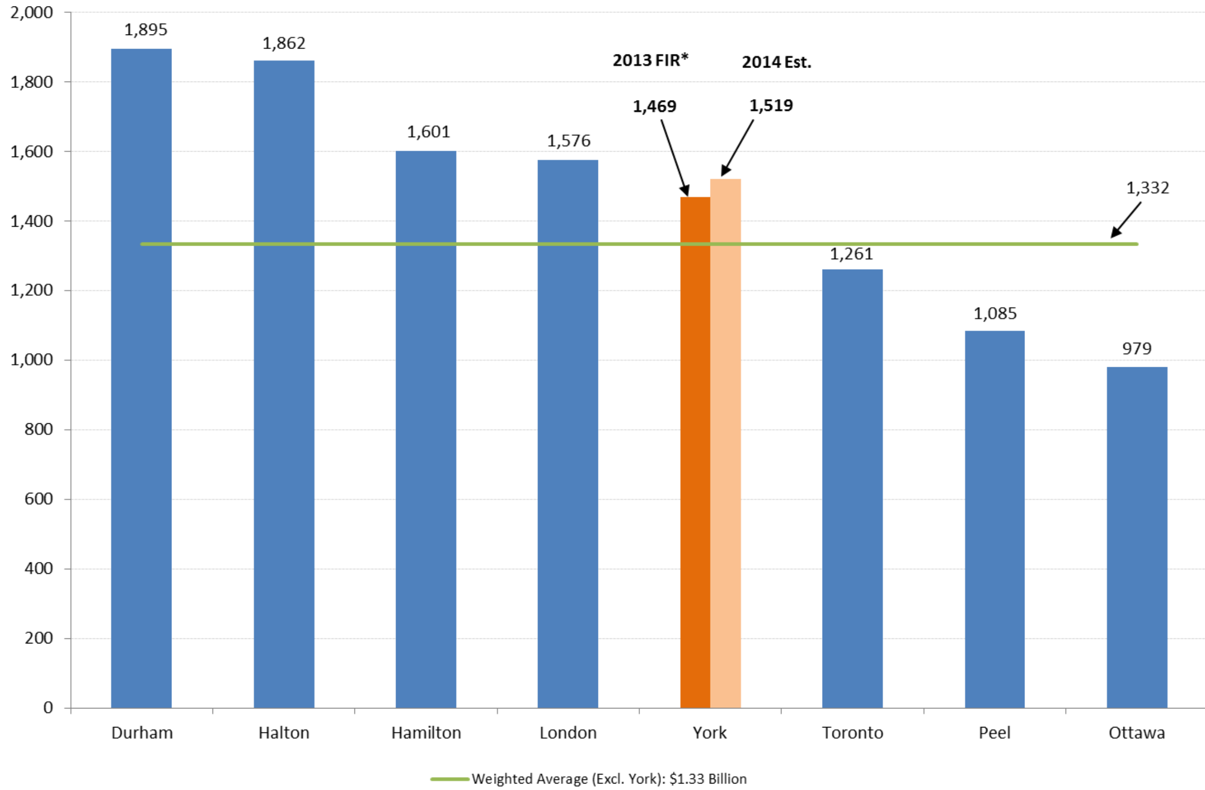
Source: York Region Finance Department

Lower-than-expected DC collections in any given year can result in a decrease in liquidity and debt servicing ability. To help mitigate this, it is Regional policy to maintain overall DC reserve balances that are at least equal to the next year's estimated DC-related principal and interest obligations. Moreover, the Region maintains significant non-DC reserves (as detailed below) that could be used to fund DC-related debt servicing costs on an interim basis, should the need arise.

Reserves are critical to the Region's debt management plan

In assessing the Region's risk profile, credit rating agencies evaluate liquidity and consider reserves an indicator of fiscal prudence. Reserves also protect the Region against non-capital long-term liabilities and external shocks. The Region has been successful in building up a high level of reserves and remains above the weighted average of comparable municipalities, as shown in Chart 6.

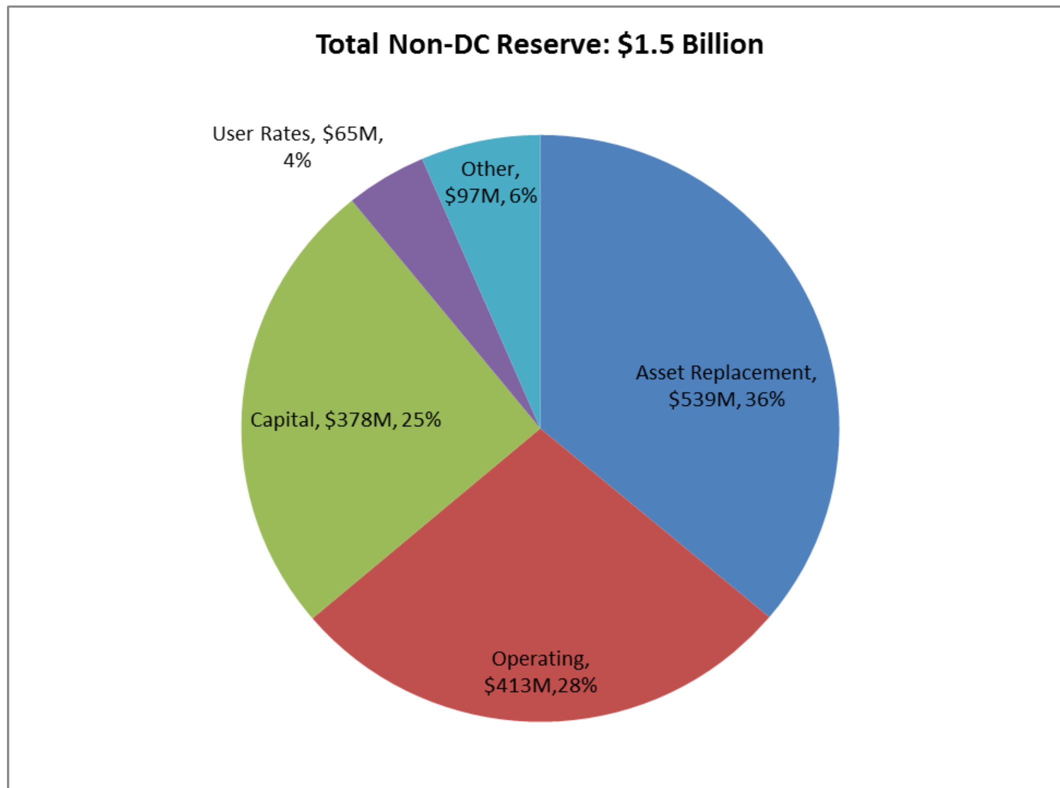
Chart 6
Reserves Per Capita Comparison*
($Millions)



*Source: Figures for comparator peer group are based on results summarized in 2013 Financial Information Returns.

The Region has a number of different non-growth reserves, broadly categorized into capital, asset replacement, operating, user rates, and other reserves, as summarized in Chart 7.

Chart 7
Summary of Non-DC Reserves
Forecast December 31, 2014



Source: York Region Finance Department

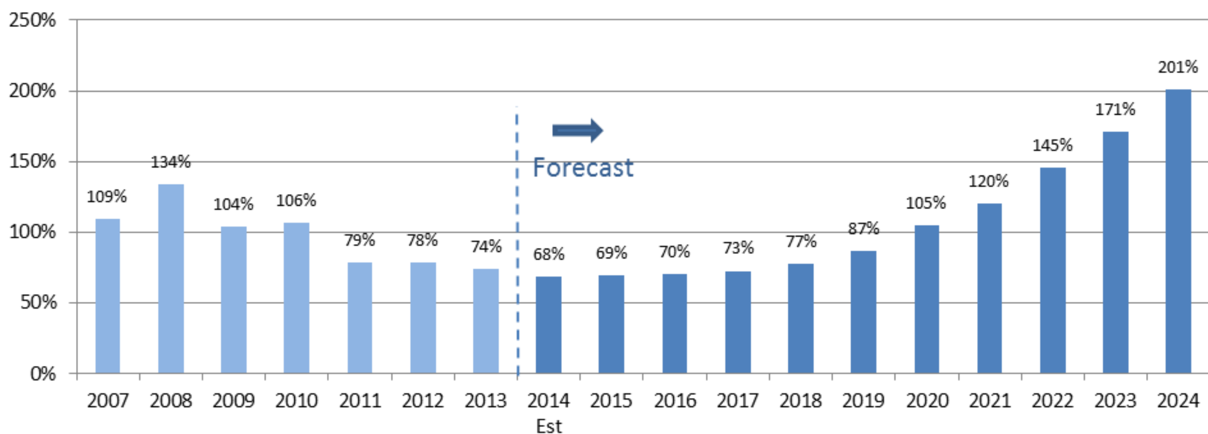
The fiscal strategy involves continuing to build up reserves over time to help meet future capital funding requirements

As infrastructure ages, it periodically needs major (usually expensive) rehabilitation and ultimately needs to be replaced. Since asset replacement is a cost incurred for existing assets, development charges cannot be used for this purpose. Therefore, funding sources such as taxes and/or user rates must be used to pay for asset replacement. To minimize the impact that rehabilitation needs will have on tax/rate payers in any given year, debentures may be used to spread the costs out over time.

An alternative to issuing debt is to build and set aside reserves specifically to fund future capital rehabilitation and replacement. To this end, Council approved a policy in 2006 of increasing the annual contributions for asset replacement reserves by an increment equal to 1 per cent of the prior year's tax levy. In 2013, Council amended this policy to gradually increase that increment by 0.2 per cent each year until it reaches 2 per cent of the prior year's tax levy in 2017. The fiscal strategy maintains this policy and anticipates the annual contribution for 2015 will be approximately $75 million, increasing to approximately $117 million by 2018. In addition, annual operating surpluses help build reserves, in accordance with Council's approved surplus management policy.

As illustrated in Chart 8, the ratio of reserves to debt has been deteriorating significantly since 2010 as the need for growth-related debt continues to outpace the receipt of growth-related revenues. However, as a result of the measures contained in the fiscal strategy, the ratio will stabilize over the next four years and then trend sharply upward, reaching 200 per cent by 2024. Ratio greater than 100 per cent indicates the Region is a net "investor" as opposed to a net "borrower."

Chart 8
Reserve to Debt Ratio
Actual and Forecast
2007-2024



Source: York Region Finance Department

Reserves will be used to reduce tax-levy related debt requirements

One way to mitigate the risks associated with the Region's future debt requirements is to eliminate that need for debt altogether. For this purpose, staff undertook a detailed review of debt-financed tax-levy related capital expenditures to determine if cash funds on hand (i.e., reserves/reserve funds) could be used in place of debt. In 2014, the Debt Reduction Reserve was established for this purpose. As a result, tax-levy-related debt needs were reduced by a total of approximately $477 million over the 2015 to 2024 forecast period, avoiding approximately $292 million in principal and interest costs over the same period. At this time, we are not anticipating a need for any new tax levy debt during the ten year forecast period.

We have built an increase into our expected costs of debt financing over time

The debt forecast will be sensitive to interest rate fluctuations over the forecast period. For example, a 1 per cent increase in interest rates would result in approximately $0.68 million in additional annual financing costs for every $100 million in debt, assuming a twenty-year term.

Interest rates are currently at historical lows and are expected to increase moderately in the near term. Interest rate assumptions have been adjusted based on a review of current and historic

rates so as to incorporate the impact of increasing rates on the ARL. Moreover, interest rates are weight-averaged to incorporate the actual cash flow timing of a given year's CSA commitment to reflect the multi-year nature of these projects. Interest rate assumptions are summarized in Table 2.

Table 2
Interest Rate Forecast
2015-2024

Interest Rate	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Annual Estimate (%)	5.00	5.30	5.50	5.50	6.00	6.00	6.25	6.25	6.25	6.50
Weighted Average (%)	5.29	5.42	5.54	5.53	6.04	6.69	6.69	6.25	6.90	6.91

Interest rate fluctuations will also affect debt with refunding provisions. Refunding provisions occur where the debt amortization period (e.g., 20 years) is longer than the contractual terms (e.g., 10 years), requiring part of the debt to be refinanced for an additional term. The concept is similar to a mortgage whereby the mortgage amortization period (e.g., 20 years) is longer than the mortgage contractual term (e.g., 5 years), requiring the borrower to refinance the mortgage upon expiration of the contractual term (e.g., obtain another mortgage contract after 5 years). For existing debt, this risk has been accounted for by calculating the annual repayment on the amount outstanding after the contract term expires using an additional ten-year term with a reforecast interest rate based on the prevailing interest rate. For new debt, forecasted annual repayments have been calculated at the rates noted in Table 2 using a twenty-year term.

We have the ability to offset market risk through a variety of mechanisms

Given the volatility of financial markets in recent years, there is a risk that borrowing costs will be higher than we expected and/or the market may not be able to absorb the issuance of new debt at the specific time when it is needed.

Interest/market risk mitigation strategies that are being employed to deal with this possibility include:

- Conservative interest rate forecasts
- Use of bond forward agreements to hedge interest costs on new debt issues when appropriate
- Pre-financing of capital projects where it is financially beneficial to do so
- Borrowing applications to government agencies such as Infrastructure Ontario
- Use of variable rate debt/lines of credit or short-term borrowing from reserves in the event of market disruption or in anticipation of significantly lower interest rates
- Use of underwriting syndicates
- An active Investor Relations program.

The debt management plan has other risks

Other risks relate to the forecast of capital infrastructure costs. Factors such as change orders, inflation, the addition of new projects, or projects being moved forward in the capital plan could result in higher debt requirements than are anticipated in this Plan. To address this risk, phase-in strategies for large capital projects will be considered when appropriate.

4. Long-Term Debt and Financial Obligations Policy

Council has approved a Capital Financing and Debt Policy that guides the overall management of the Region's current and expected financing needs and underpins this long-term debt management plan. This policy, last updated and approved by Council in 2014, is reviewed annually to identify and incorporate best practices.

The policy covers all long-term financial obligations entered into by the Region. It establishes objectives, standards of care, authorized financing instruments, and reporting requirements and responsibilities, so as to ensure that the Region's infrastructure needs are financed as effectively as possible.

5. Prudent and Cost-Effective Management of Existing and Projected Long-Term Debt and Other Financial Obligations

The Region's Capital Financing and Debt Policy sets out provisions to manage existing and projected long-term debt and other financial obligations in the most prudent and cost-effective manner possible. These provisions include:

- Parameters and risk considerations for financing leases, which can be used in certain circumstances where long-term debt financing is neither feasible nor appropriate (i.e., lease vs. buy)
- Diversification and optimization of the term structure of debentures through a review of interest rate curves
- Limiting the term of financing to the lesser of the anticipated useful life of the underlying asset or the period over which repayment will occur
- Ensuring a high standard of care by ensuring that staff are sufficiently knowledgeable with respect to standard financing transactions and/or the use of outside advice when necessary
- Maintaining an investor relations program in order to increase market awareness and boost demand for Regional debentures
- Maintaining at least a AA- credit rating to minimize interest costs and maximize access to capital markets
- Use of an underwriting syndicate to facilitate the marketing and selling of debenture issues.

6. Estimated 2015 Needs of the Region for Temporary Borrowing

Temporary borrowing needs arise from the need to finance operational expenditures pending receipt of taxes and other revenues and the need to finance capital expenditures until long-term financing is in place

The Region's temporary borrowing requirements are addressed in detail under a separate report to Council. In 2015, it is estimated that approximately $350 million will be required for operating needs. Temporary borrowing can also result from the need to interim finance capital expenditures until long-term financing is in place. In 2015, it is estimated that approximately $275 million will be required for interim capital financing.

Similar to long-term debt and financial obligations, the Province limits the amount of funding used for temporary borrowing needs to 50 per cent of budgeted total revenue from January to September of the previous year and 25 per cent from October to December.[4] The Region's estimated temporary borrowing needs noted above are well within these limits. It is Regional policy to fund these short-term needs out of reserves and this is expected to continue in 2015. Any funds borrowed from reserves are always paid back during the year of borrowing.

7. Evaluation and Comparison of 2014 Projections and Outcomes

As Table 3 shows, the Region was in compliance with its ARL for 2014. A total of $71.6 million of the 2015 capital requirement was pre-funded in 2014, and included in the 2014 new debt payment and financial obligations.

Table 3
Region's 2014 ARL
($Millions)

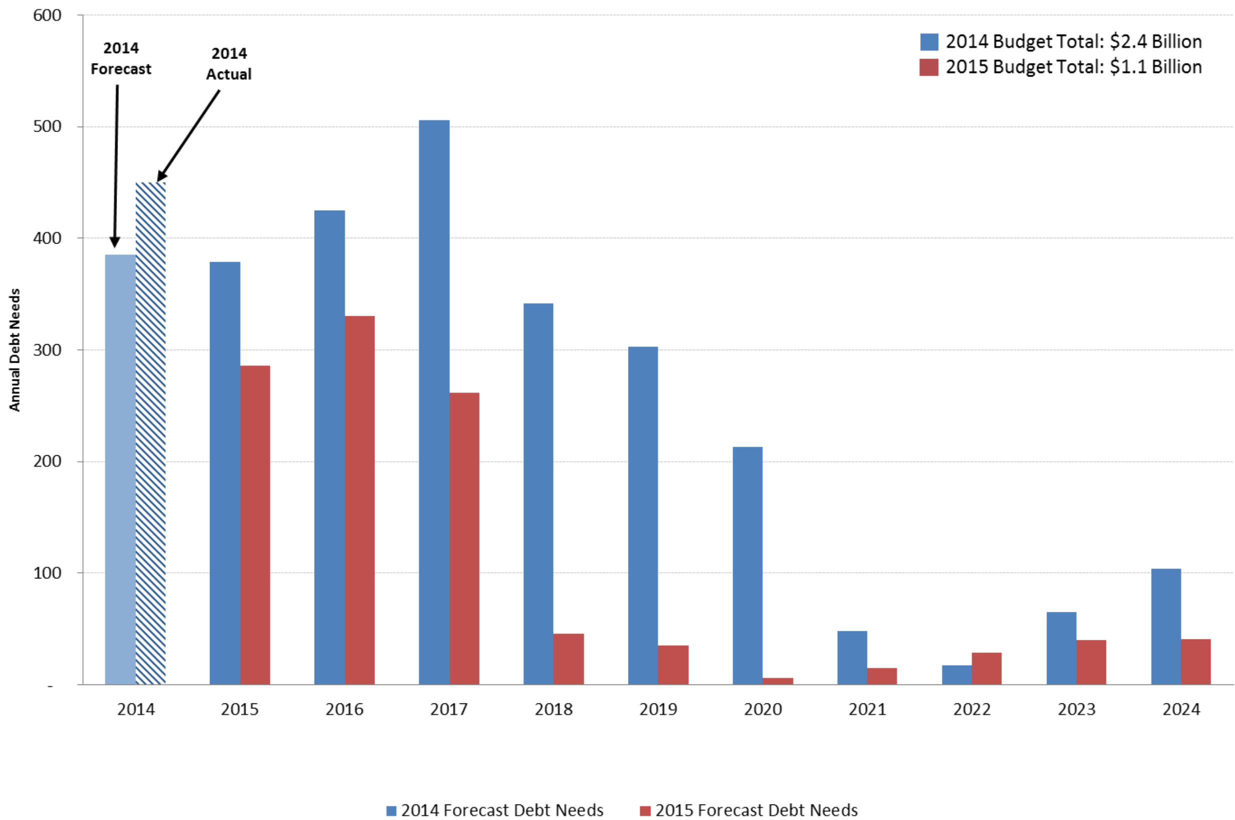
Component Description	Forecast	Actual	Difference
25% of Own Source Revenues	312	312	-
Plus: Growth Cost Supplement	192	194	2
Total ARL	**504**	**506**	**2**
Less: Existing Debt Payment and Financial Obligations	321	329	8
Less: Anticipated New Debt Payment and Financial Obligations	75	75	-
Remaining ARL	**108**	**102**	**(6)**

[4] Temporary borrowing provisions are set out in Section 405 and 407 of the Municipal Act. Temporary borrowings are not part of the ARL calculations.

2015 Long-Term Debt Management Plan

A year-over-year comparison of annual debt requirements is shown in Chart 9. The 2014 actual debt requirement includes $71.6 million of 2015 capital requirements pre-funded in 2014, whereas the 2014 forecast does not include this pre-funding of capital.

Chart 9
Comparison of Debt Needs
2014 Budget vs. 2015 Budget
($Millions)

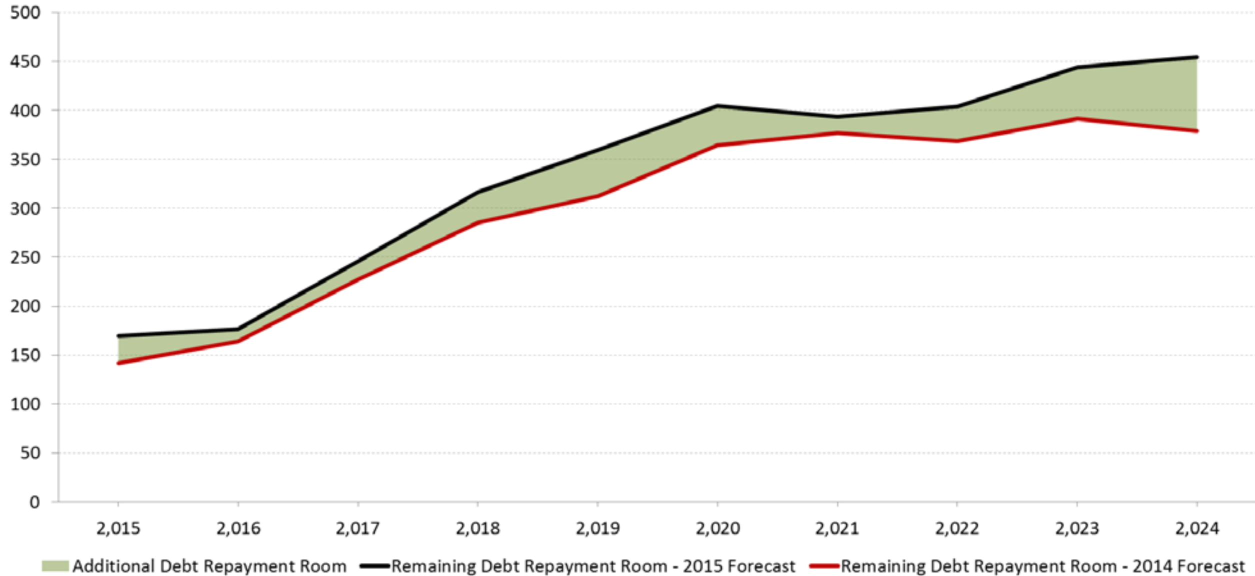


Source: York Region Finance Department

The capital plan included in the 2015 budget shows a total debt requirement of $1.1 billion over the 2015-2024 period. This represents a $1.3 billion decrease from the debt requirements identified for the same period in 2014, primarily due to fiscal strategy measures such as continuing to optimize the use of DC charge reserves to reduce reliance on DC debt and deferring capital projects to align capital spending more closely with the fiscal plan.

As illustrated in Chart 10, the decrease in debt requirements has reduced the pressures on the Region's ARL identified in previous forecasts and has provided additional annual debt repayment room. This will also help to further mitigate other risks such as DC collection uncertainty and interest rate risk. Overall, the Region's financial flexibility has improved significantly from the 2014 forecast.

Chart 10
Comparison of Forecasted Remaining
Annual Repayment Room
2014 vs. 2015
($Millions)



Source: York Region Finance Department

8. Conclusion

The long-term debt management plan addresses the matters that Council is required to consider before adopting the plan. The financing that the Region requires to fund and manage its capital plan is within its Annual Repayment Limit. Staff will continue to assess the long-term implications of the ARL methodology as outlined in the Regulation.

2015 Long-Term Debt Management Plan

APPENDIX 1
Determination of ARL

<u>Step 1:</u> Calculate 25 per cent of Own Source Revenue

Own source revenue includes:

- Property tax revenue
- Water and wastewater revenues
- Transit fares
- Fees provided for police services, public housing rents, and fees from services provided to other municipalities.

Own source revenue does not include development charges, grants and subsidies from other levels of government, other deferred revenues (e.g., gas tax revenues), and contributions from reserves.

Table A1 provides the 2015-2024 forecast based on information and assumptions contained in the 2015 Operating Budget.

2015 Long-Term Debt Management Plan

Table A1
Annual Repayment Limit Calculation – 25 per cent of Own Source Revenues
Forecast Budget Years 2015-2024
($Millions)

ARL Determination	Budget Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
	FIR Year[1]	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Net Revenues											
Property Taxes/PIL's[2]		880	892	918	964	1,009	1,051	1,091	1,132	1,176	1,220
User Rates - Sewage/Water/Solid Waste		225	259	267	292	317	345	358	372	386	401
Transportation User Fees		65	70	69	72	75	78	81	83	85	88
Other User Fees[3]		39	29	33	37	38	39	39	40	41	41
Provincial Fines		11	13	12	12	12	12	12	12	12	12
Other Revenue[4]		121	63	71	74	88	106	71	76	82	92
Total - Net Revenues[5]		**1,341**	**1,326**	**1,370**	**1,451**	**1,539**	**1,631**	**1,652**	**1,715**	**1,782**	**1,854**
25% of Net Revenues		**335**	**331**	**343**	**363**	**385**	**408**	**413**	**429**	**445**	**464**

Notes:

1. Own Source Revenues from two years prior to the current year are included in current year ARL calculations as represented by Financial Information Return (FIR) Year. FIR Year 2013 is based on actual results. FIR Year 2014 is based on the 2014 Operating Budget. FIR Years 2015-2018 are based on the 2015 Operating Budget and departmental estimates for outlook years.
2. Property Taxes for FIR Years 2015 assume approximately 2.16 per cent assessment growth plus 0.81 per cent net tax levy growth for a total of 2.97 per cent. Property Taxes for FIR 2019-2022 are assumed to grow at an average annual rate of 3.8 per cent.
3. Other User Fees include revenues generated by: Police Services, Public Health, EMS, Community and Health Services, Social Housing, and Planning. FIR Years 2015-2018 are based on the 2015 Operating Budget and grow at an average annual rate of 1.4 per cent. Other User Fees for FIR Years 2019-2022 are assumed to continue grow at the same average annual rate of 1.4 per cent.
4. Other Revenue includes: Investment Income, Sale of Publications, recoveries and etc. Investment income is based on reserve balance forecasts assuming a rate of return of 3.0 per cent for FIR Years 2015-2018 and 2.5 per cent for FIR Years 2019-2022.
5. Total Net Revenues equal total budgeted net revenues from the 2015 Operating Budget and departmental estimates of the outlook years. These are forecast to increase at an average annual rate of 4.4 per cent over the forecast period (e.g., FIR Years 2015-2022).

Step 2: Calculate Growth Cost Supplement

The growth cost supplement is based on development charge collections. The Regulation allows the Region to include an amount equal to 80 per cent of the average DC collections for the previous three fiscal years. A forecast of DC collections is also required as part of this plan.

The DC collections forecast was developed for 2015 to 2024. A DC collection estimate was generated for 2014, based on the actual year-to-date collections realized by December, and historic trends in monthly DC collections.

DC collections are very sensitive to economic conditions and can vary from year to year. Key factors influencing annual development charges collections include the following:

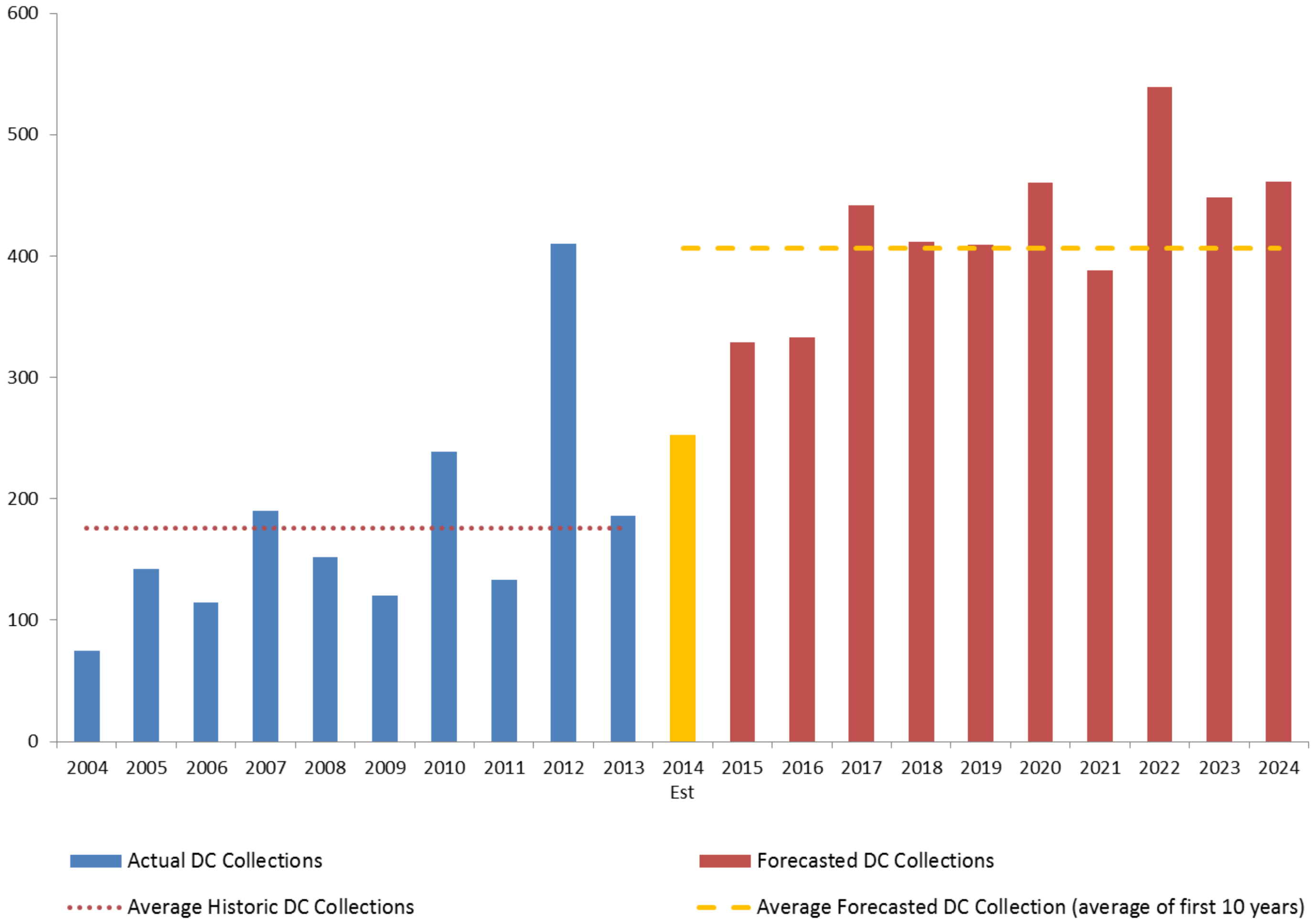
1. The amount of development activity in the Region, including registration of new residential subdivisions and the issuance of building permits for residential and non-residential buildings
2. DC rate changes and transitional provisions such as prepaid DC agreements that could lead to early registration, and result in lower collections in subsequent years
3. DC collection policies such as DC deferrals that change the timing of DC collections.

The 2015 to 2024 collections forecast is generated using econometric models that differentiate between the short, medium and long terms:

- The short-term forecast is based on quarterly new unit sales, a strong leading indicator of building permit issuance
- The medium term forecast is based on anticipated population growth, interest rates and GDP growth
- The long-term forecast is informed by demographic and policy factors including population and employment growth and planned density
- In addition, the DC collections forecast is informed by:
    - Recent trends in the relationship between employment growth and non-residential construction activities
    - Recent data on average gross floor area of non-residential developments
    - Regional policies regarding DC prepayments, deferrals and exemptions

Historic and forecast DC collections are provided in Chart A1 below.

Chart A1
Annual DC Collections Actual and Forecast
($Millions)



Source: York Region Finance Department

Over the ten year period 2004-2013, annual collections have averaged approximately $176 million, with peaks in 2012, 2010, and 2007 due primarily to developer acceleration of the pace of development in anticipation of rate increases. Collections were significantly lower in 2008 and 2009 due to the economic recession. The 2014 collection is estimated to be $253 million. The actual historic average collection level is not a good indicator of future average collections because DC rates have increased, and the Region has stopped the practice of phasing in DC rate increases.

Average DC collections from 2014 to 2024 are anticipated to increase to approximately $407 million annually. This is largely due to the expectation that the Region will continue to grow.

Step 3: Calculate Total ARL

The final step is to calculate the total ARL by adding the revenues and collections calculated in Steps 1 and 2 above, as summarized in Table A2.

Table A2
Total ARL 2015-2024
($Millions)

Component Description	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Total Own Source Revenues	1,341,229	1,325,719	1,370,123	1,450,866	1,539,489	1,630,879	1,652,352	1,715,282	1,781,651	1,854,350
25% of Own Source Revenues (A)	**335,307**	**331,430**	**342,531**	**362,717**	**384,872**	**407,720**	**413,088**	**428,821**	**445,413**	**463,587**
DC Collections (3-year rolling avg.)	282,754	255,851	305,005	368,067	395,614	421,063	427,161	419,397	462,487	458,467
DC Cost Supplement (%)	70%	70%	70%	70%	70%	70%	70%	70%	70%	70%
DC Cost Supplement ($) (B)	**197,928**	**179,096**	**213,504**	**257,647**	**276,930**	**294,744**	**299,013**	**293,578**	**323,741**	**320,927**
Growth Related Debt and Fin. Ob. Limit (ARL) (A+B)	**533,235**	**510,526**	**556,035**	**620,364**	**661,802**	**702,464**	**712,101**	**722,399**	**769,154**	**784,514**

Note:

1. While the Regulation allows the Region to include an amount equivalent to 80 per cent of the average DC collections for the previous three fiscal years as growth cost supplement, the 2015 to 2024 ARL is calculated based on 70 per cent DC collection for conservative projection purposes.