Regional Fiscal Strategy

Presentation to

Committee of the Whole

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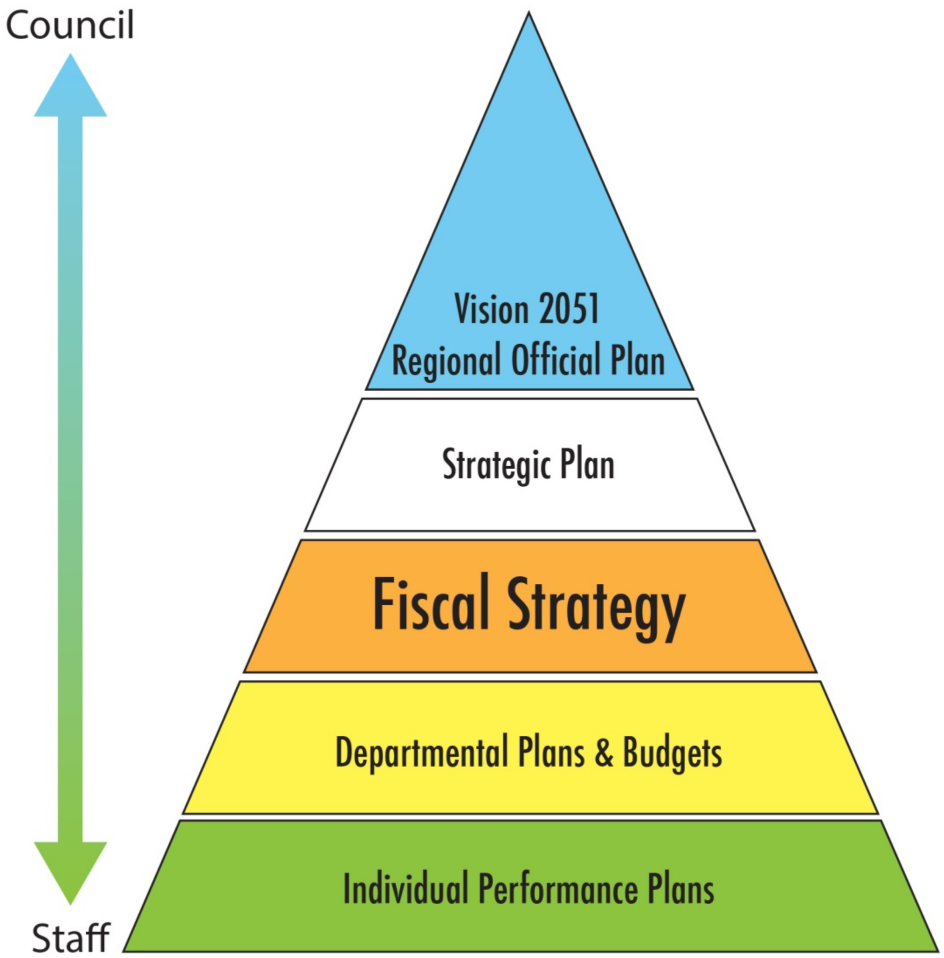
December 12, 2013

Presentation Overview

- Fiscal Strategy Overview
- Reserves
- Debt
- Long-Term Debt Management Plan

Fiscal Strategy Overview

The Region's Plans and Service Delivery Rely on a Sound Fiscal Strategy



Elements of the Fiscal Strategy

In the Next 10 Years

Disciplined Management of the Capital Plan		Large Infrastructure Investment = $6.6B
+		Capital Asset Replacement Reserves ↑ $1.2B
Aggressive Savings for Asset Replacement and Debt Reduction	→	New Tax-Levy Debt ↓ $400M
+		New DC-Related Debt ↓ $1B
Time		Peak Debt Level ↓ $1.5B

Reserves

Why Are Reserves Needed?

- Reserves are critical to the Region’s debt management plan because:
  - Credit rating agencies evaluate liquidity and consider reserves an indicator of fiscal prudence
  - Adequate reserves reduce the need to issue debt
  - Reserves enable future investment in capital asset replacement and renewal
- Reserves also protect the Region against non-capital long-term liabilities and external shocks

The Region Holds Reserves for Different Purposes

$517M
33.1%
Capital Reserves

$384M
24.6%
Replacement Reserves

$378M
24.2%
Development Charge Reserves

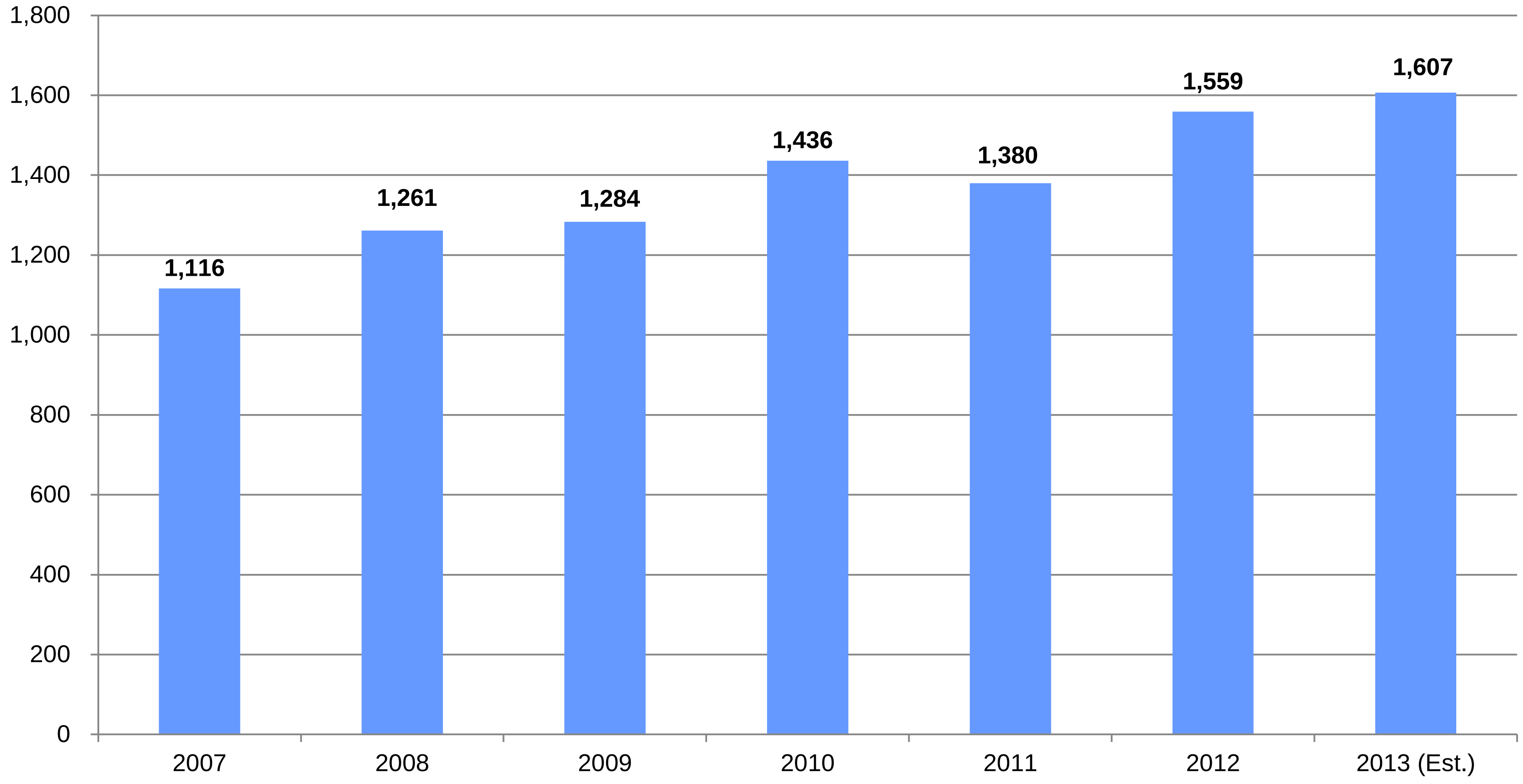
$123M
7.9%
Corporate Reserves

$89M
5.7%
Other Reserves

$70M
4.5%
Human Resource Reserves

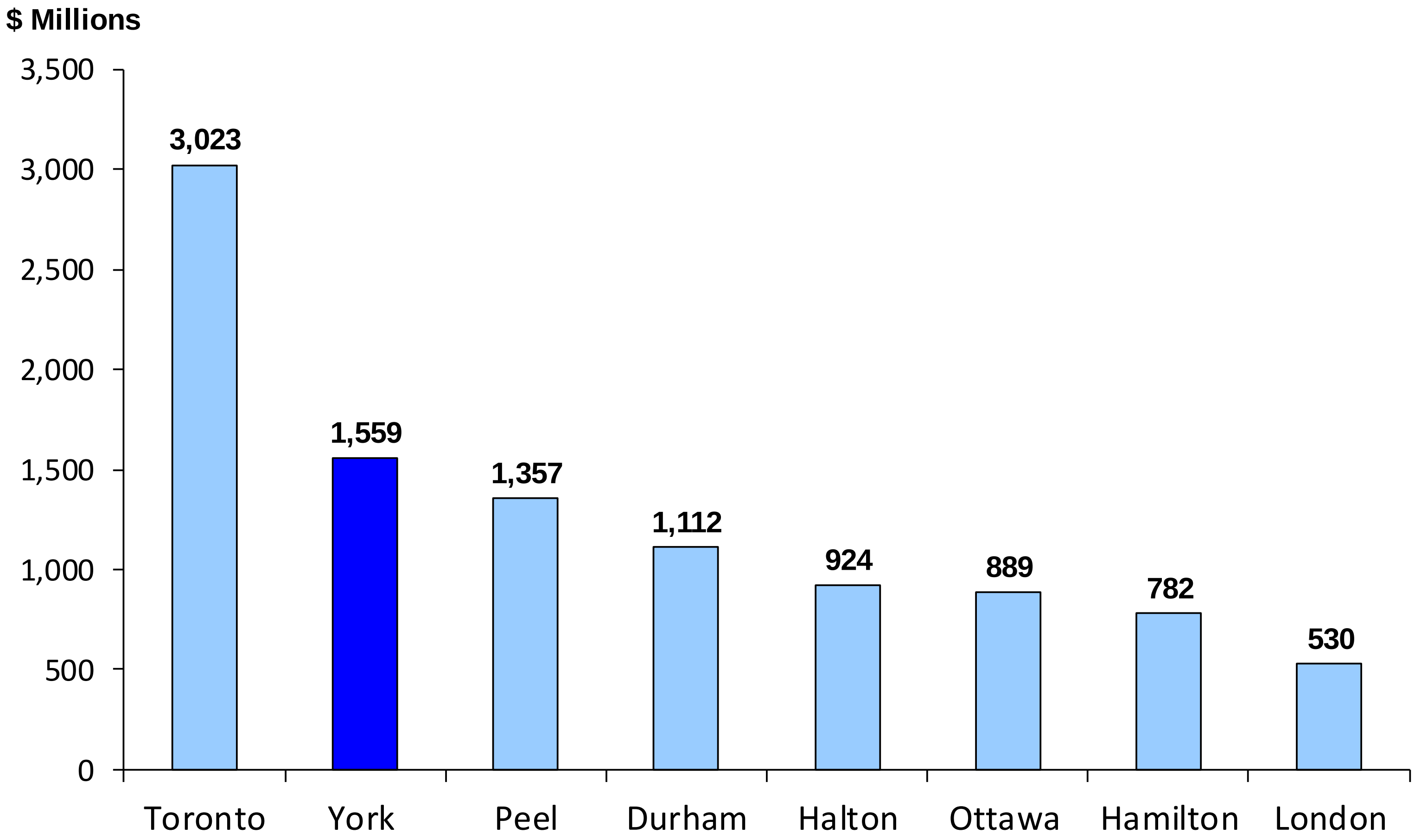
Most reserves are for capital investment

Historical Reserve Balances



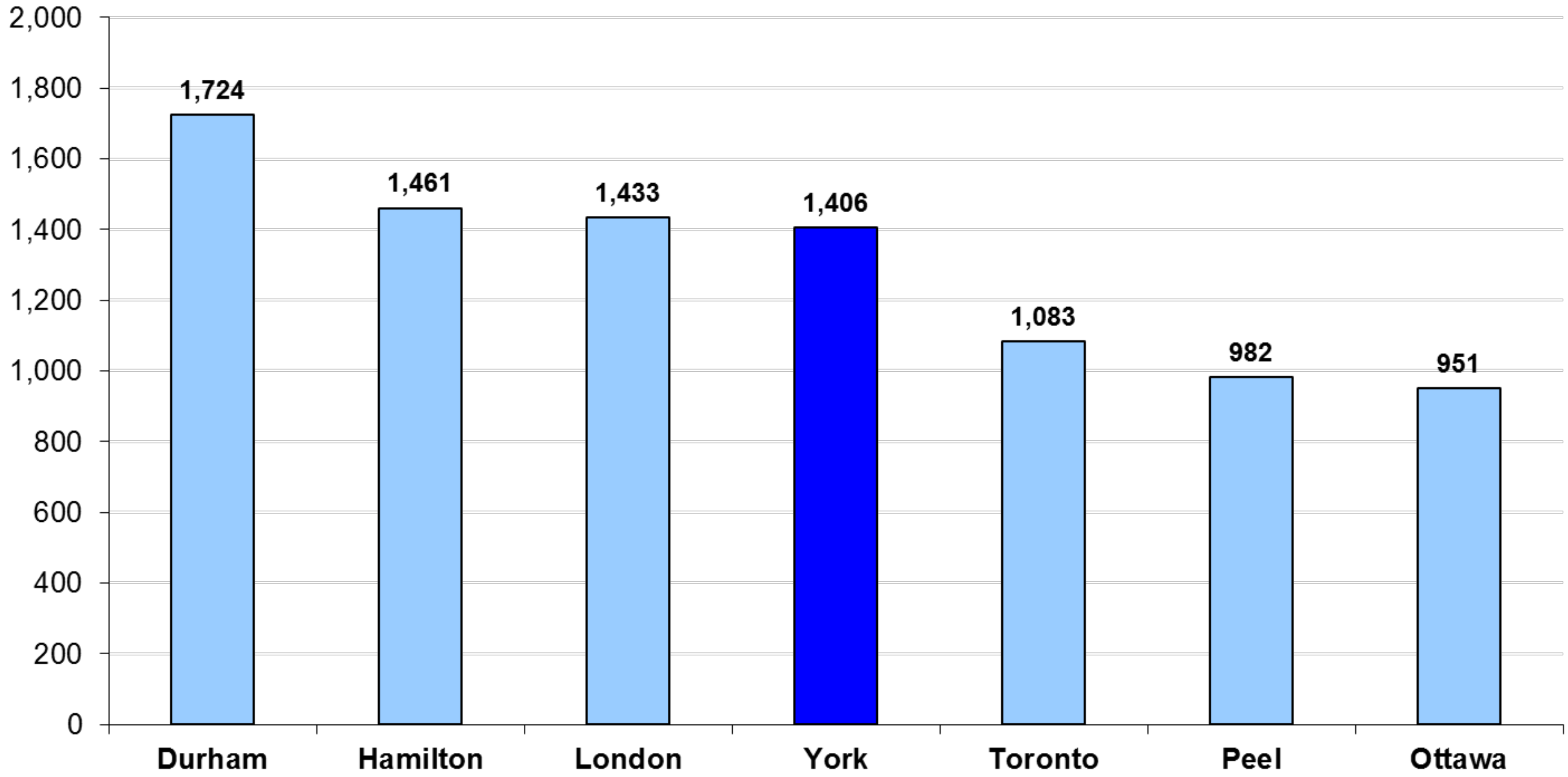
York Region's reserves have increased by 44% since 2007

High Level of Reserves Compared to Others



In 2012, York Region’s reserves were second only to Toronto

Healthy Reserves Per Capita in 2012



York Region's reserve levels per capita compare well to other municipalities

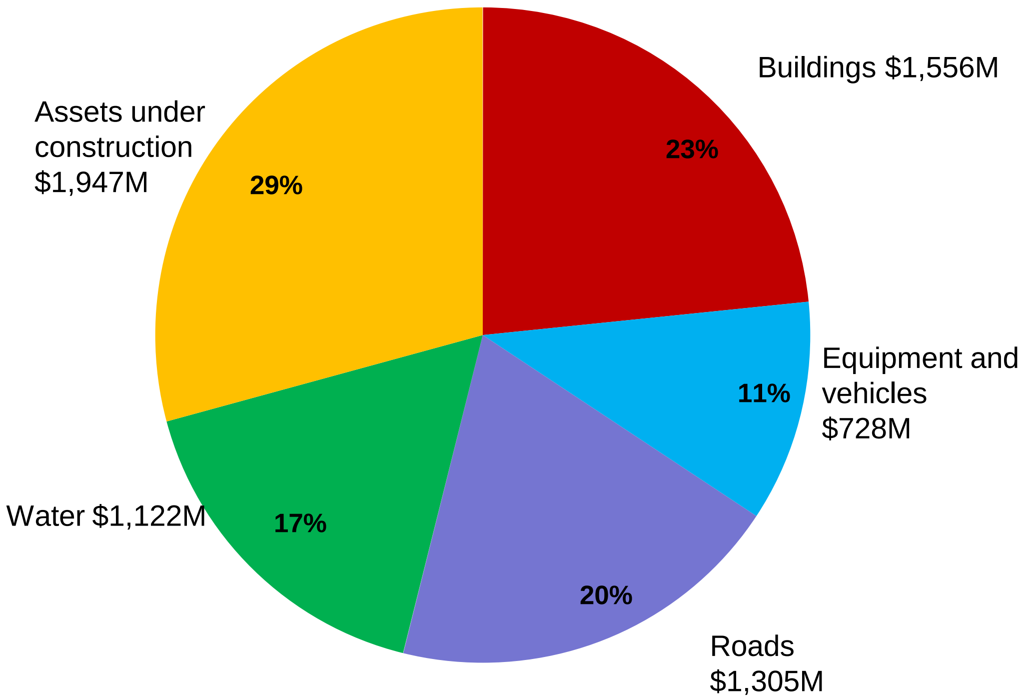
Essentials of Capital Reserve Management Strategy

- Increase savings for long-term asset renewal and replacement
- Create a new Debt Reduction Reserve
- Use surplus and supplemental tax policy to build the asset replacement and debt reduction reserves
- Apply reserves judiciously to capital projects to reduce the need for debt

Need for Future Capital Asset Replacement Reserves

Original Cost of Tangible Capital Assets as of December 31, 2012 by Department (in millions) – Excluding Land

Total = $6.658 Billion



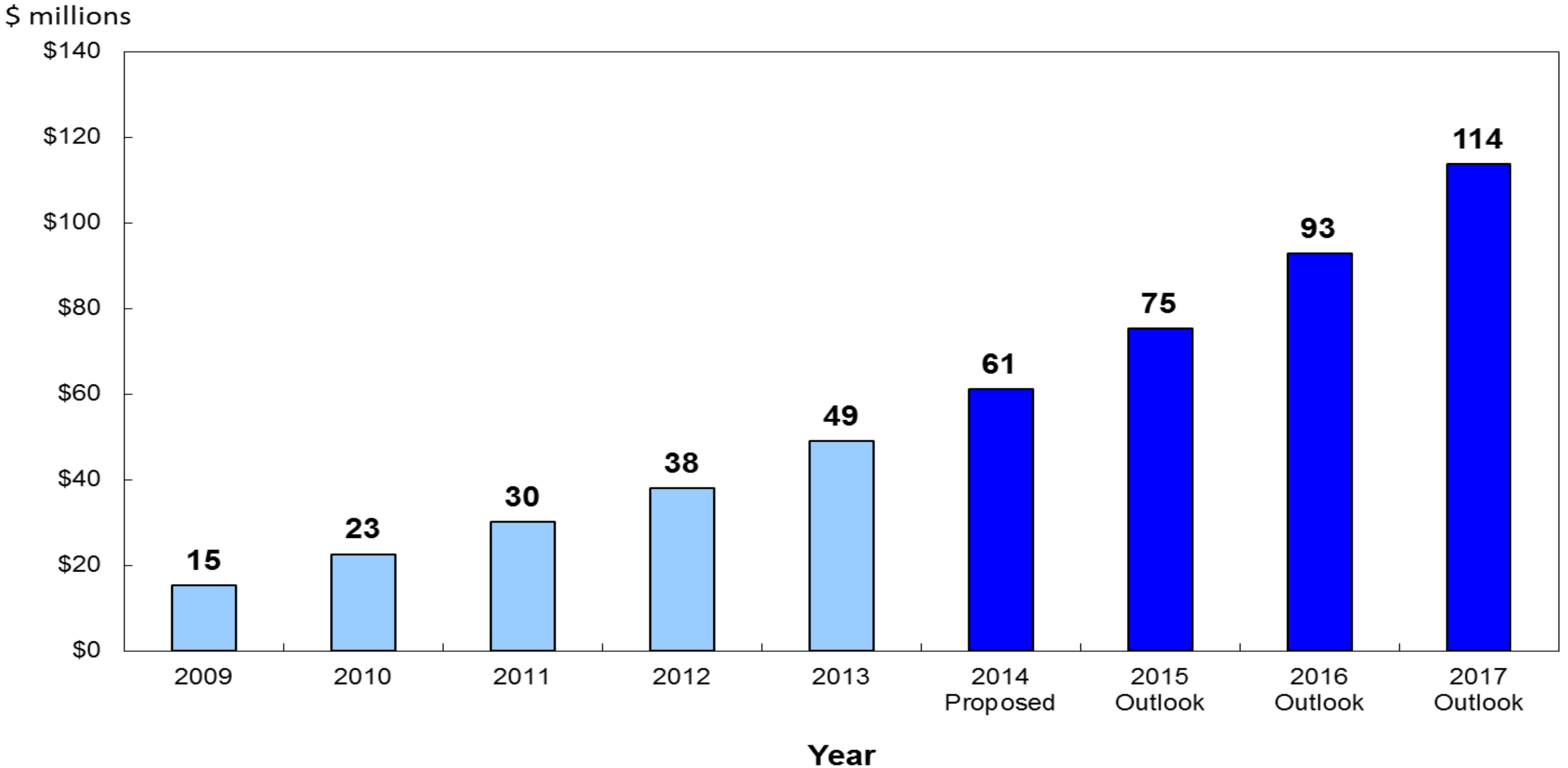
- As infrastructure ages, it periodically needs major (usually expensive) rehabilitation and ultimately needs to be replaced
- Development charges cannot be used for this purpose
- Insurance appraisals indicate that the replacement value of a representative sample of Regional assets is 40% more than the original cost and more than twice the current net book value

Capital Asset Replacement Reserve Policy is in Place

- Since 2007, Council has directed that the allocation to capital asset replacement reserves be increased by 1% of the prior year's tax levy each year

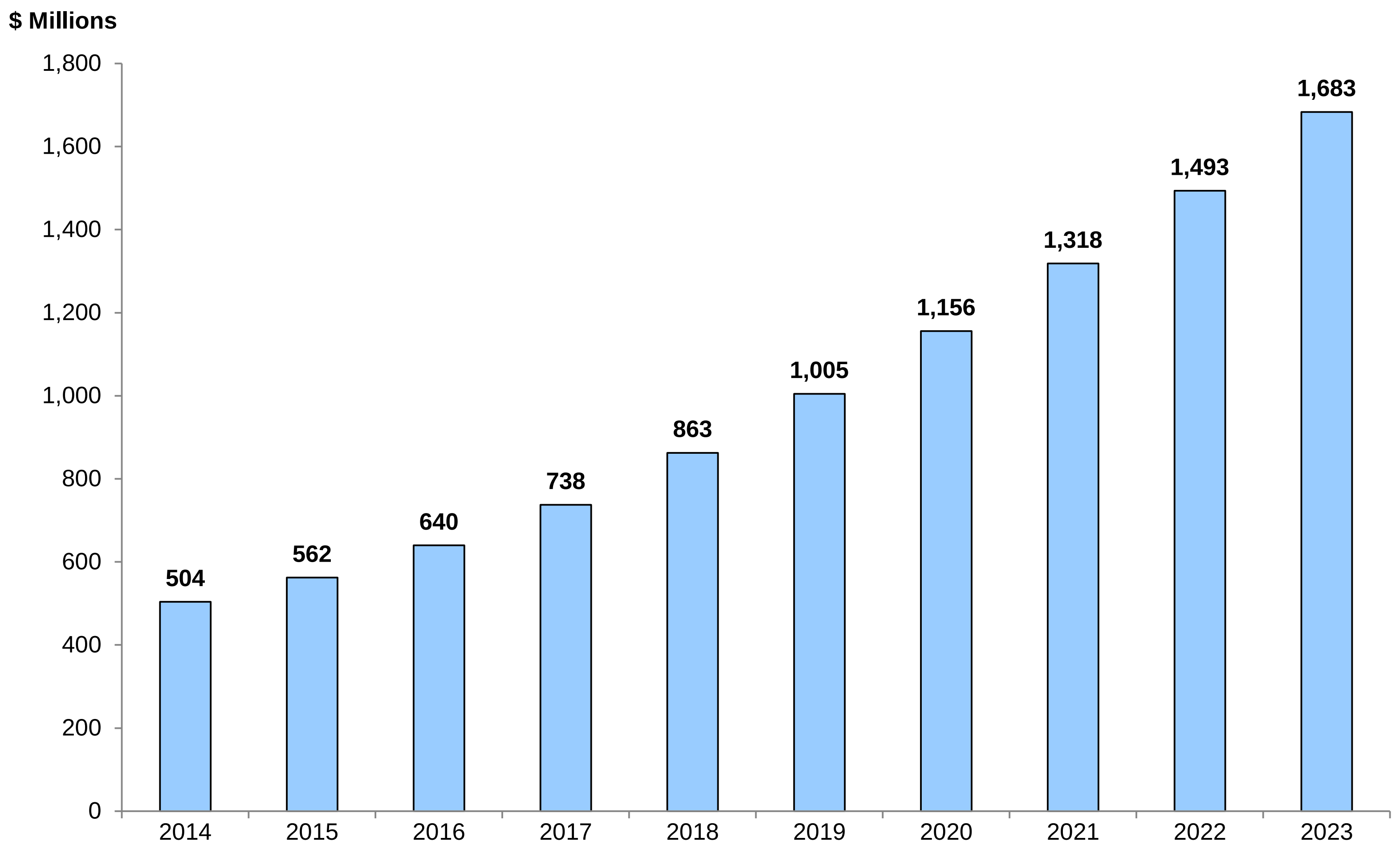
- Starting in 2013, Council directed that the increment be increased by 0.2% annually until it reaches 2% in 2017.

Impact of Capital Asset Replacement Reserve Policy



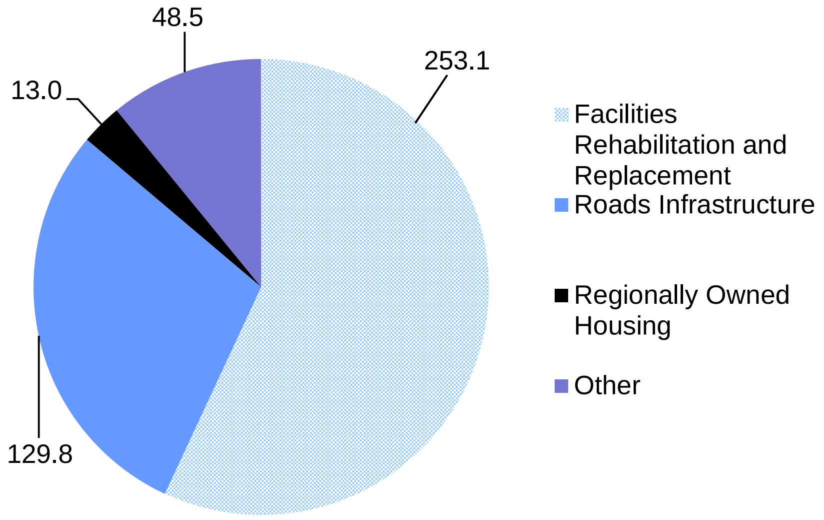
Contributions to capital asset replacement reserves are continuing to grow

Strong Growth in Capital Asset Replacement Reserve Balances



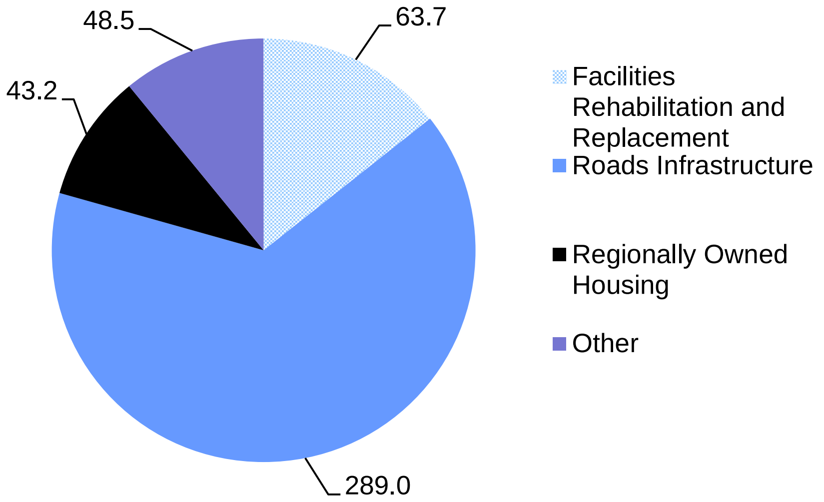
Asset Replacement Reserves Rebalanced to Reflect Forecast Needs (as at Dec. 13)

Before Rebalancing



Total = $444.4M

After Rebalancing



Total = $444.4M

The effect of the rebalancing is to shift replacement reserve funds to roads and housing

Proposed Debt Reduction Reserve

- A proposed new Debt Reduction Reserve will be used to minimize tax levy debt for capital projects
- Initial estimates indicate that the Debt Reduction Reserve will eliminate over $400 million of tax levy debt over the next 10 years
- This will save the Region approximately $175 million in interest and principal payments

Setting Up the Debt Reduction Reserve

Seeding the Debt Reduction Reserve	**$ Millions**
Unspent debt reduction funding (from prior years)	16
Transfer from General Capital Reserve	121
Transfer from Other Reserves	55
2014 Contribution	17
Total	209

Building the Debt Reduction Reserve

Policy	Current Policy	Proposed New Policy
Surplus Policy	Regional Operating Surplus: (order of priority) 1. Cover contingent liability reserves (Working Capital, LTD, WSIB, Insurance) 2. Fuel Stabilization Reserve, if needed 3. Remainder to General Capital Reserve	Regional Operating Surplus: (order of priority) 1. Cover contingent liability reserves (Working Capital, LTD, WSIB, Insurance) 2. General Capital Reserve, if needed 3. Fuel Stabilization Reserve, if needed 4. Remainder to Debt Reduction Reserve
Supplementary Tax Policy	50% General Capital 50% Capital Asset Replacement	50% Capital Asset Replacement 50% Debt Reduction Fund
Operating Budget Contribution	$11.8 million annually	Minimum of $11.8 million annually plus 50–100% of avoided financing costs in future years

Note: Housing Operating Surpluses will not change under the revised Surplus Policy (80% to Social Housing Development Reserve, 20% to the Working Capital Reserve)

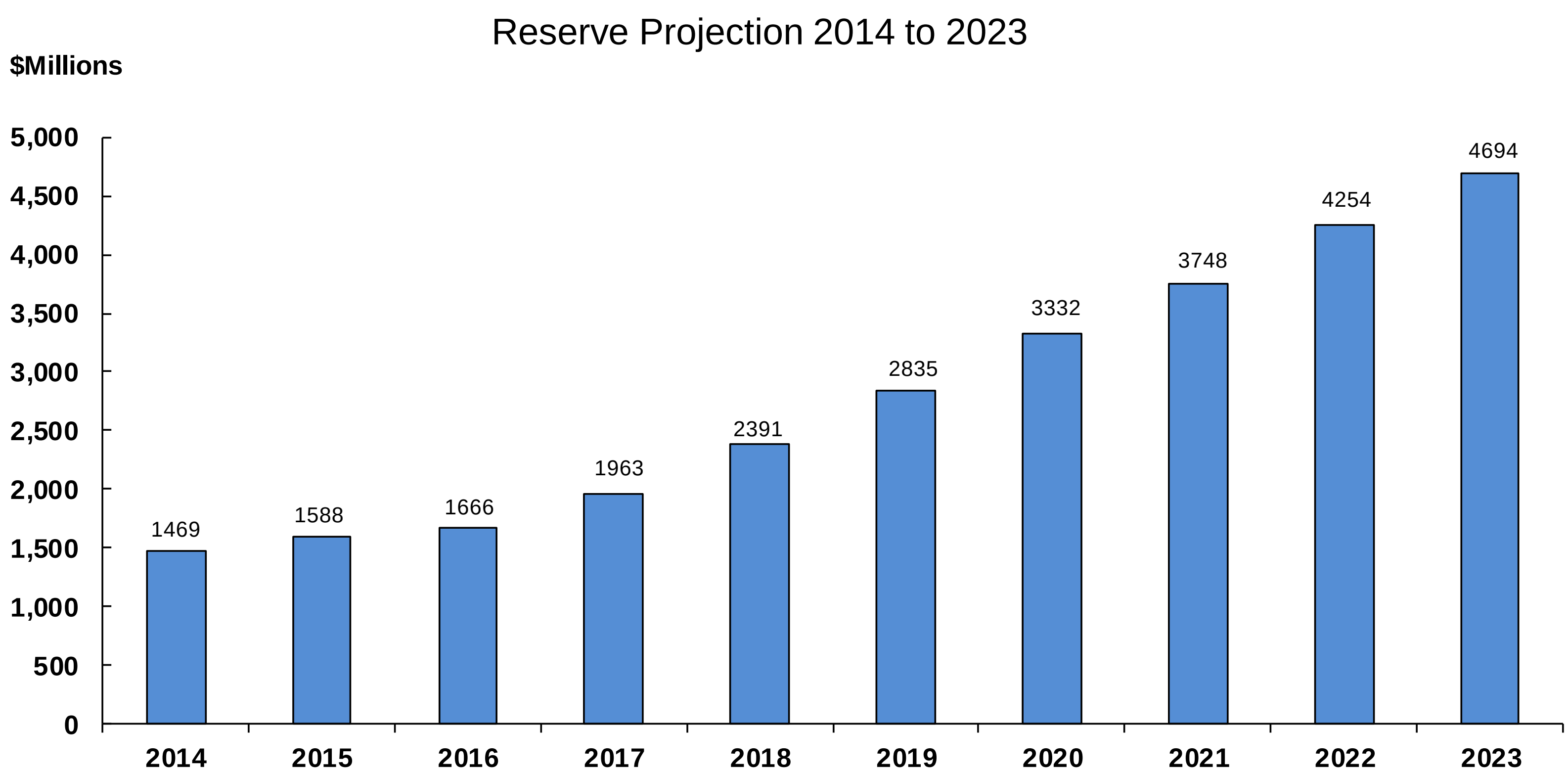
Additional New Reserves to be Established

- Land Banking Reserve
  - To purchase land required for future use as identified in the capital plan
- Sinking Fund Reserve
  - To centralize payments and related interest earned that are associated with the Region’s sinking fund debentures
- Transit Vehicle Replacement Reserve
  - To refurbish and replace transit vehicles

Other Administrative Matters

- Reserves to be closed
  - **Highway 48 Reserve** – Remaining balance to be transferred to an asset replacement reserve at the Commissioner of Finance's discretion
  - **Highway 7 Reserve** – Balance to be transferred to a replacement reserve at the Commissioner of Finance's discretion
  - **Computer Software Acquisition Reserve** – Remaining funds to be transferred to the Equipment Replacement Reserve
- $7.95 million to be drawn from the Move Ontario Reserve to fund the Toronto-York Subway Extension (TYSSE) project

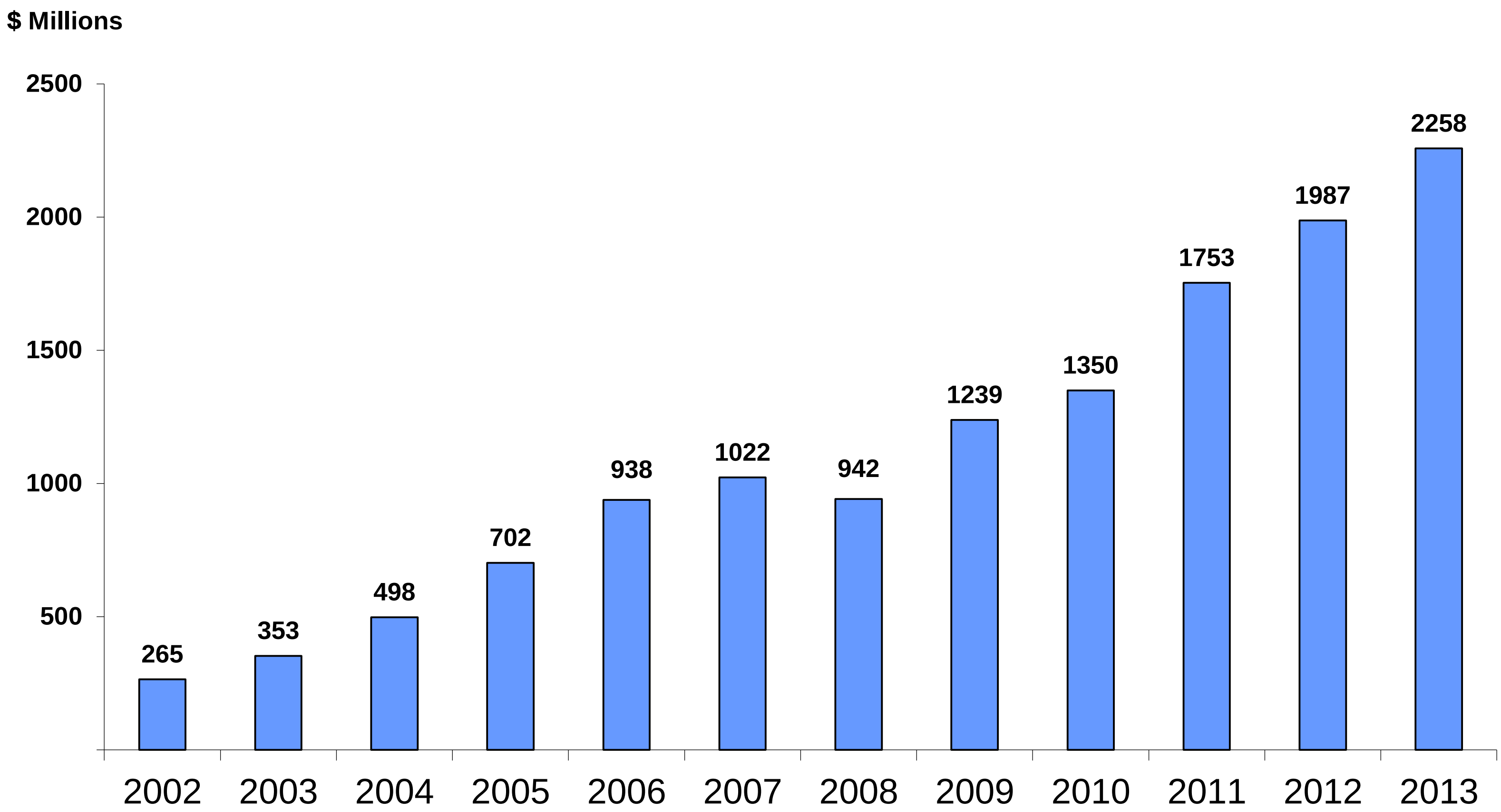
Growing Reserves



Reserve balances are robust and are expected to more than triple in the next ten years

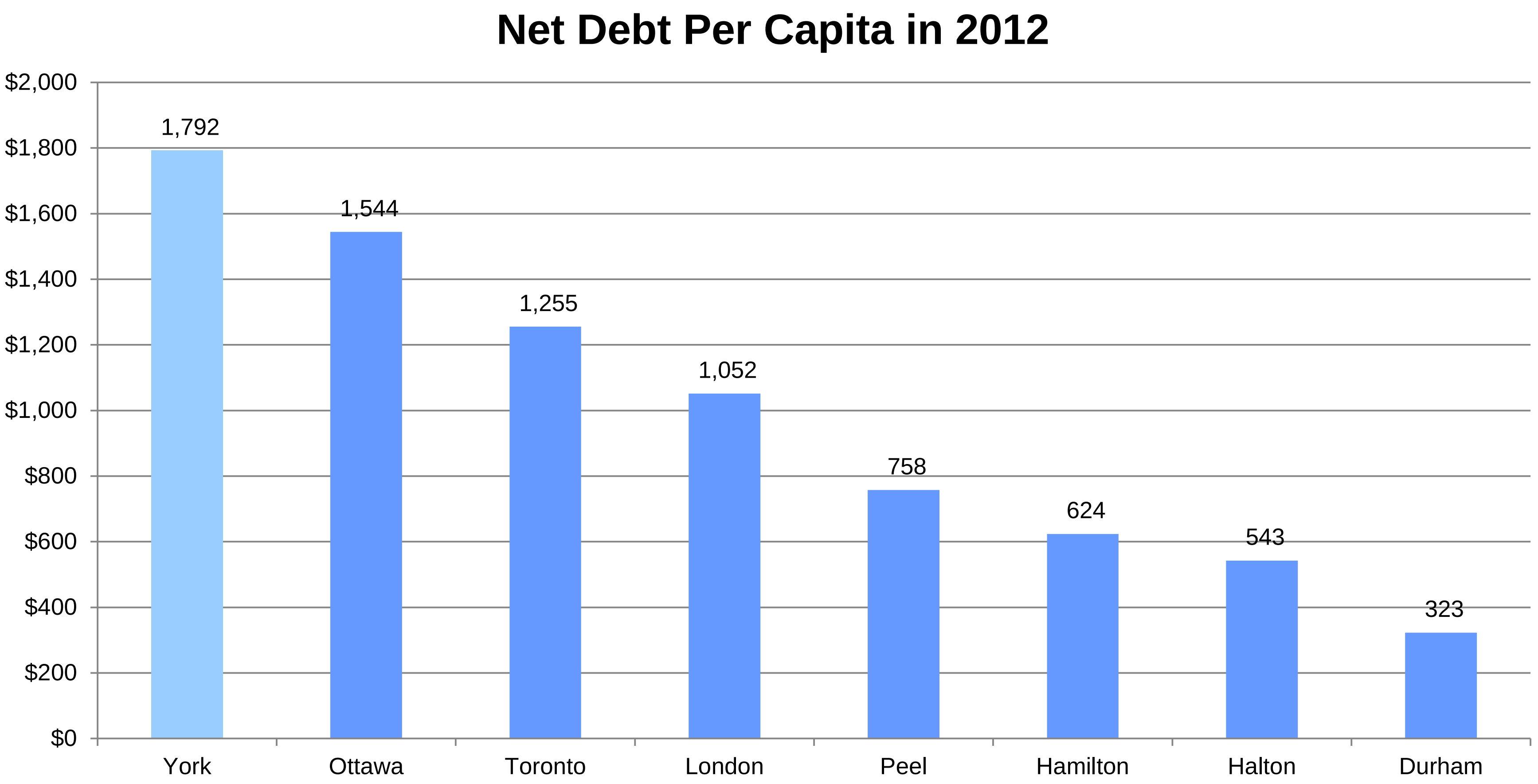
Debt

Historical Debt Levels



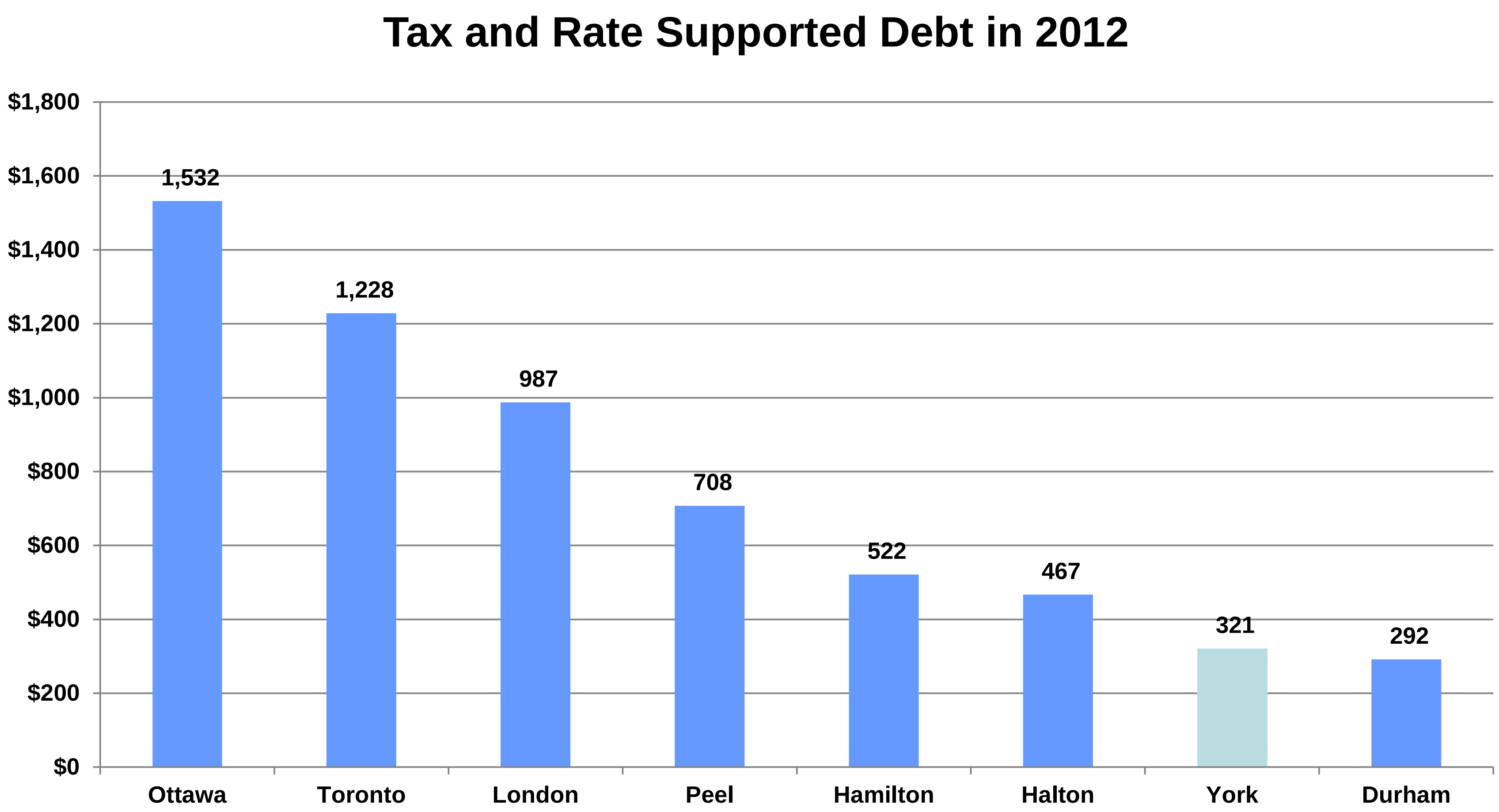
The Region's current debt is $2.26 billion

Debt Per Capita Comparison

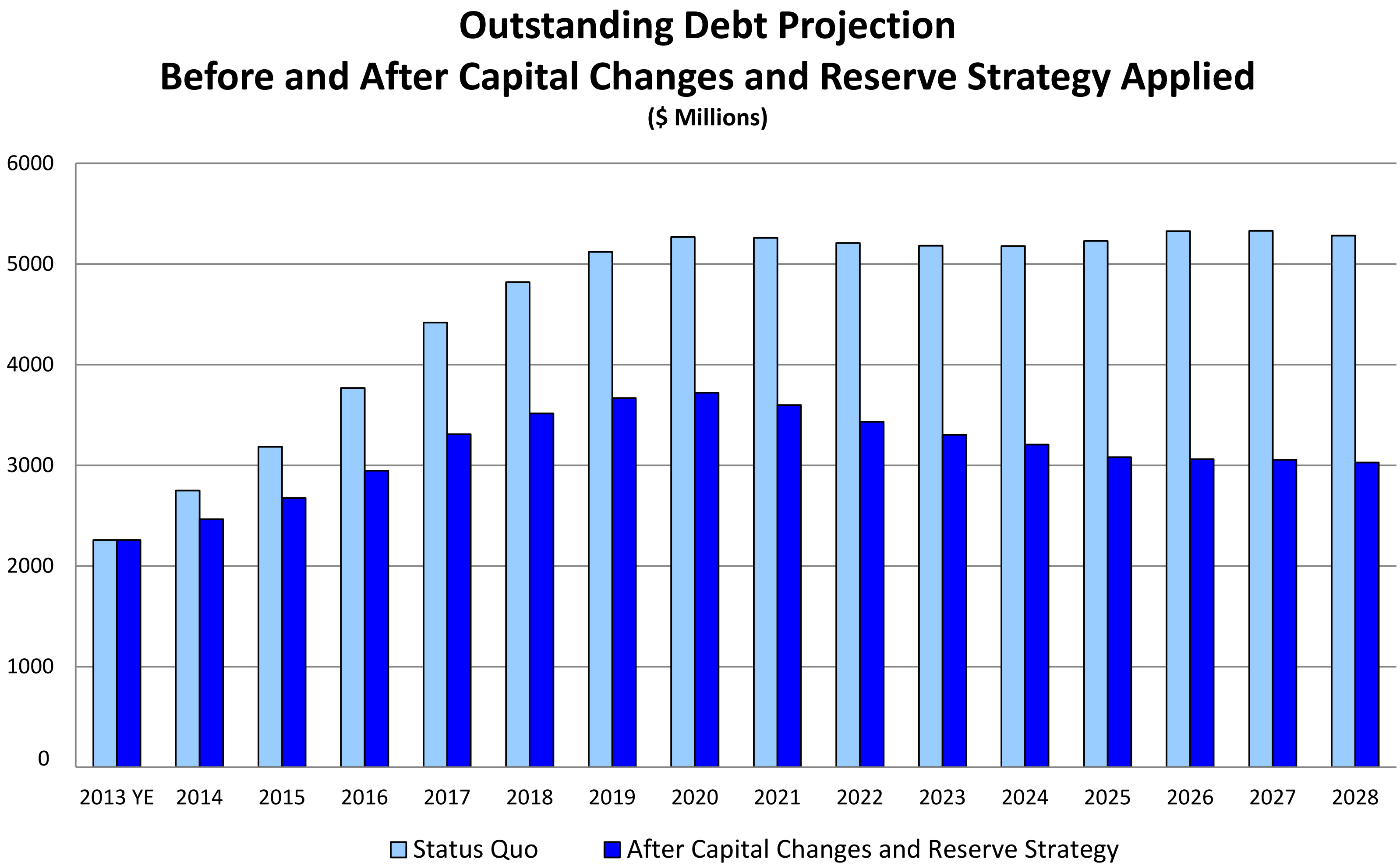


Debt per capita is not a good indicator of the impact of debt on existing residents

Low Tax and Rate Supported Debt

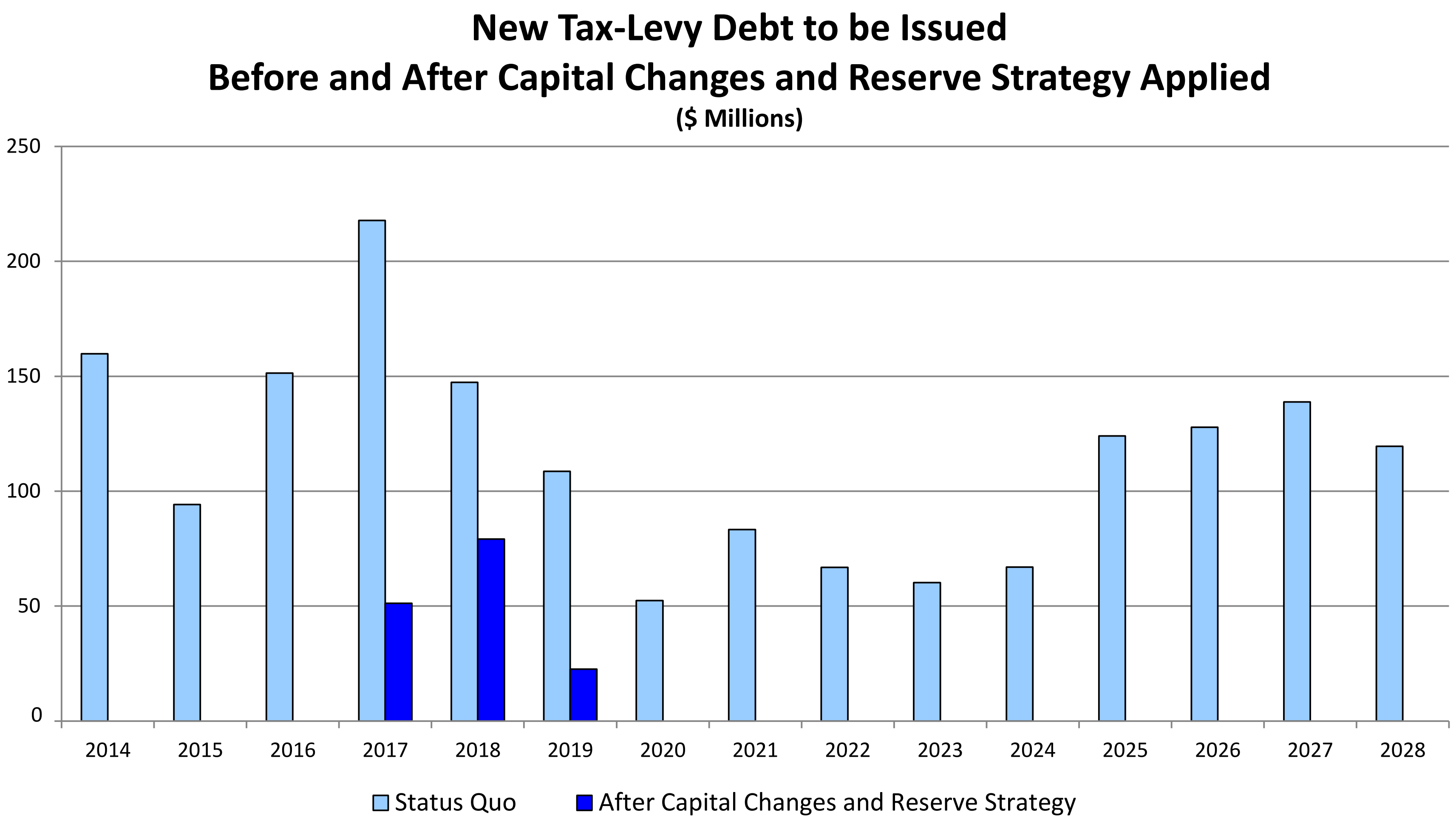


Capital Changes and Reserve Strategy Substantially Reduce Debt

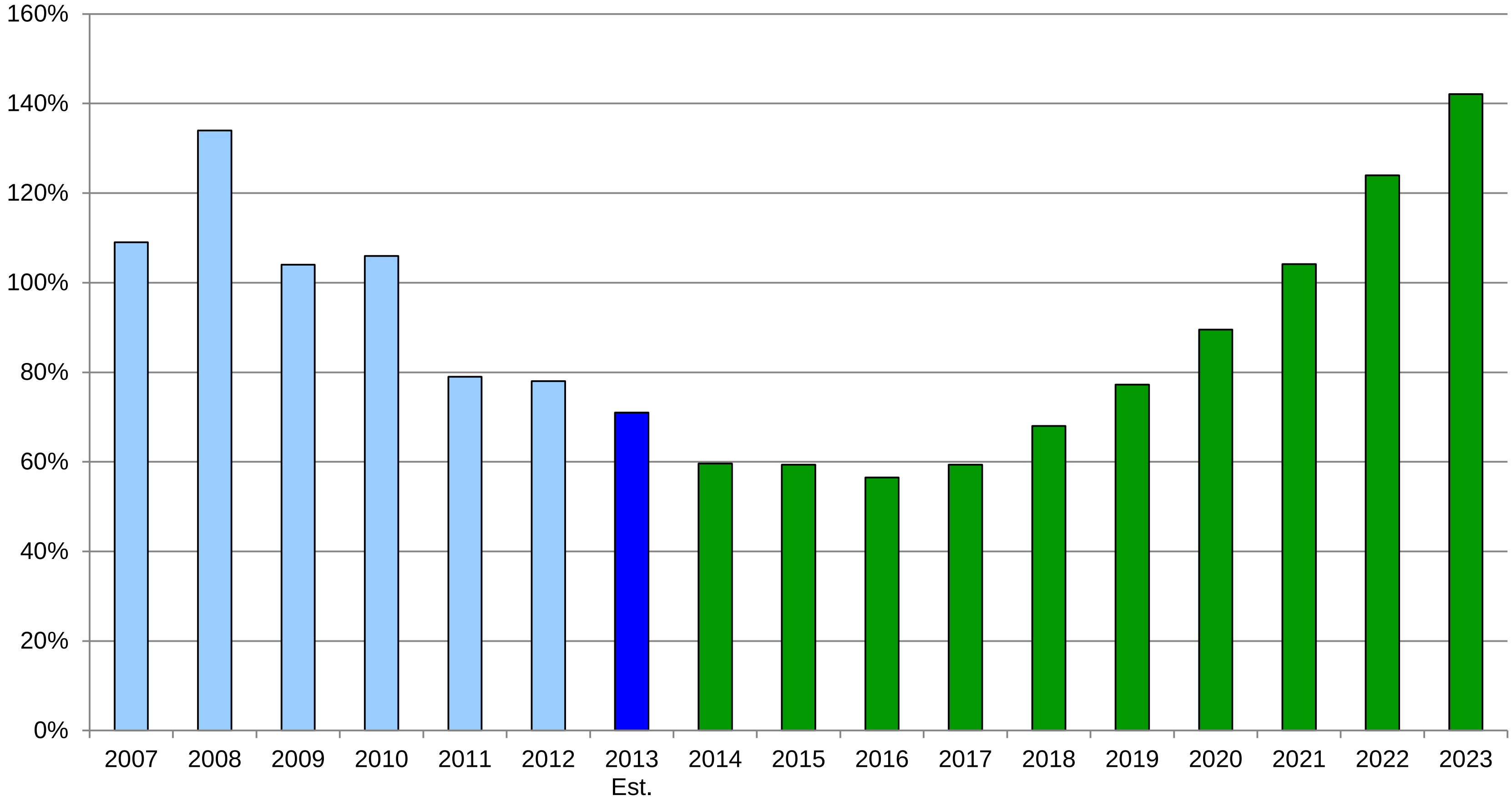


York Region

New Reserve Strategy Will Reduce New Debt Funded From Tax Levy



Reserve to Debt Ratio Will Improve



The reserve to debt ratio will remain relatively stable for the next four years and then rise rapidly

Debt Management Plan

Components of the Debt Management Plan

- Background
- Long-term Debt Needs
- Annual Repayment Limit (ARL) Calculation and Forecast
- Risks and their Mitigation Strategies
- Capital Financing and Debt Policy
- Temporary Borrowing Needs
- 2013 Projections and Outcomes

Constraints on Authorization of New Debt

- In Ontario, the amount of debt that can be authorized by a municipality is restricted by the provincial Annual Repayment Limit (ARL) Regulation

- Councils may not approve financial obligations that will, in total, exceed 25% of a municipality's own-source revenues, not including development charge collections

- Financial obligations include all forms of long-term mortgage and debenture financing payments as well as lease payments and other future commitments/liabilities to third parties (i.e., hospital funding)

York-Specific ARL Calculation

- New formula enacted by Province in July 2011 gives the Region additional debt room

- A Growth-related “Cost Supplement” calculated as 80% of the average of previous three years’ DC collections is added to the base ARL

- Two conditions must be met in order to be eligible for the Cost Supplement:
  1. Region must maintain a minimum AA (low) credit rating
     - ✓ Condition met: as of November 2013, Region has maintained AAA credit rating with Moody’s and S&P
  2. Council must annually adopt or affirm a Long-Term Debt Management Plan as part of its budget for the fiscal year

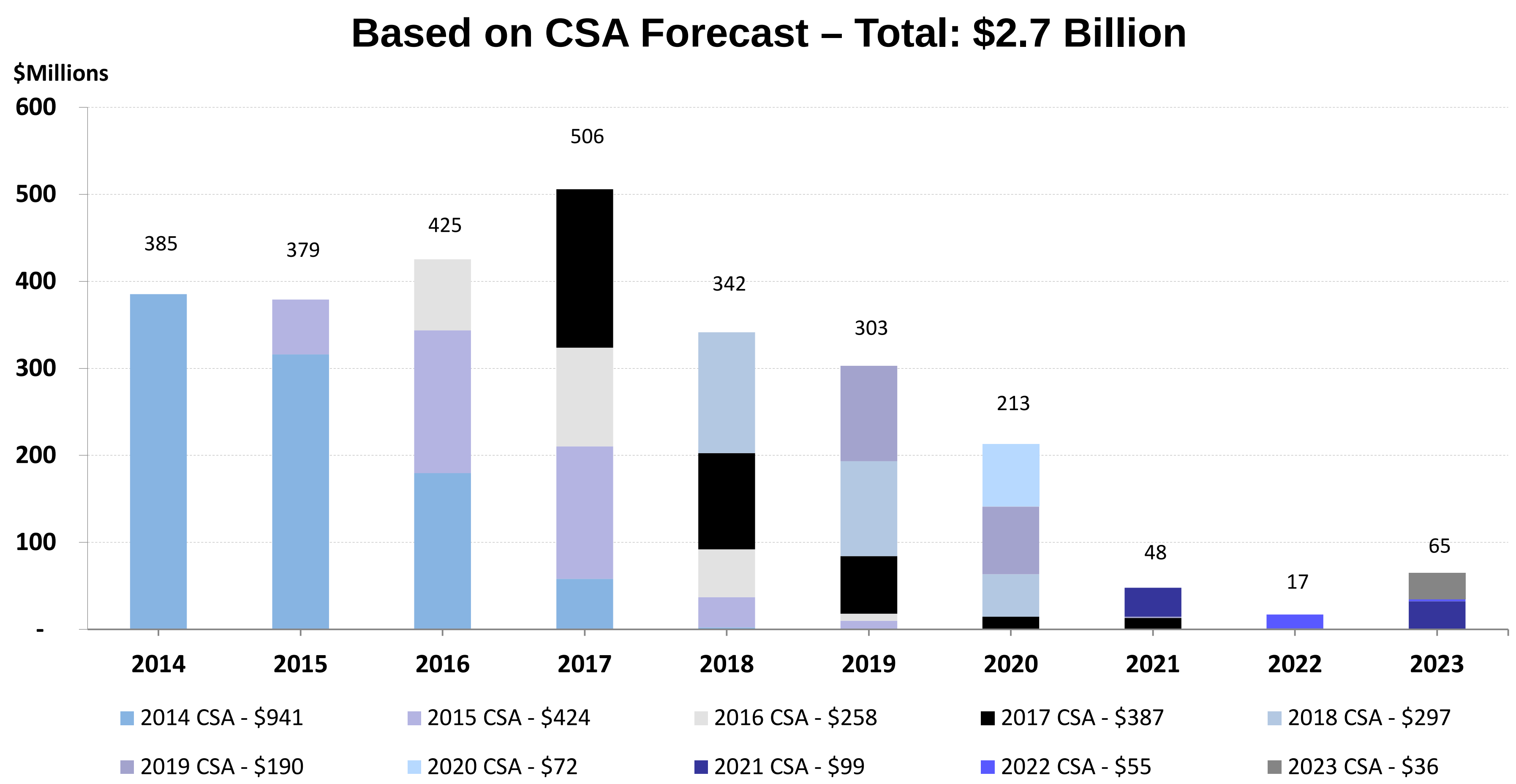
Capital Spending and the ARL

- Capital Spending Authority (CSA) is granted based on contractual and other clear or certain commitments to capital, not on a cash payment basis
- The debt-financed portion of Capital Spending Authority is considered a debt commitment for the purposes of the ARL
- The Region has to pay close attention to its ARL because of the robust capital program currently underway, a significant portion of which is debt financed

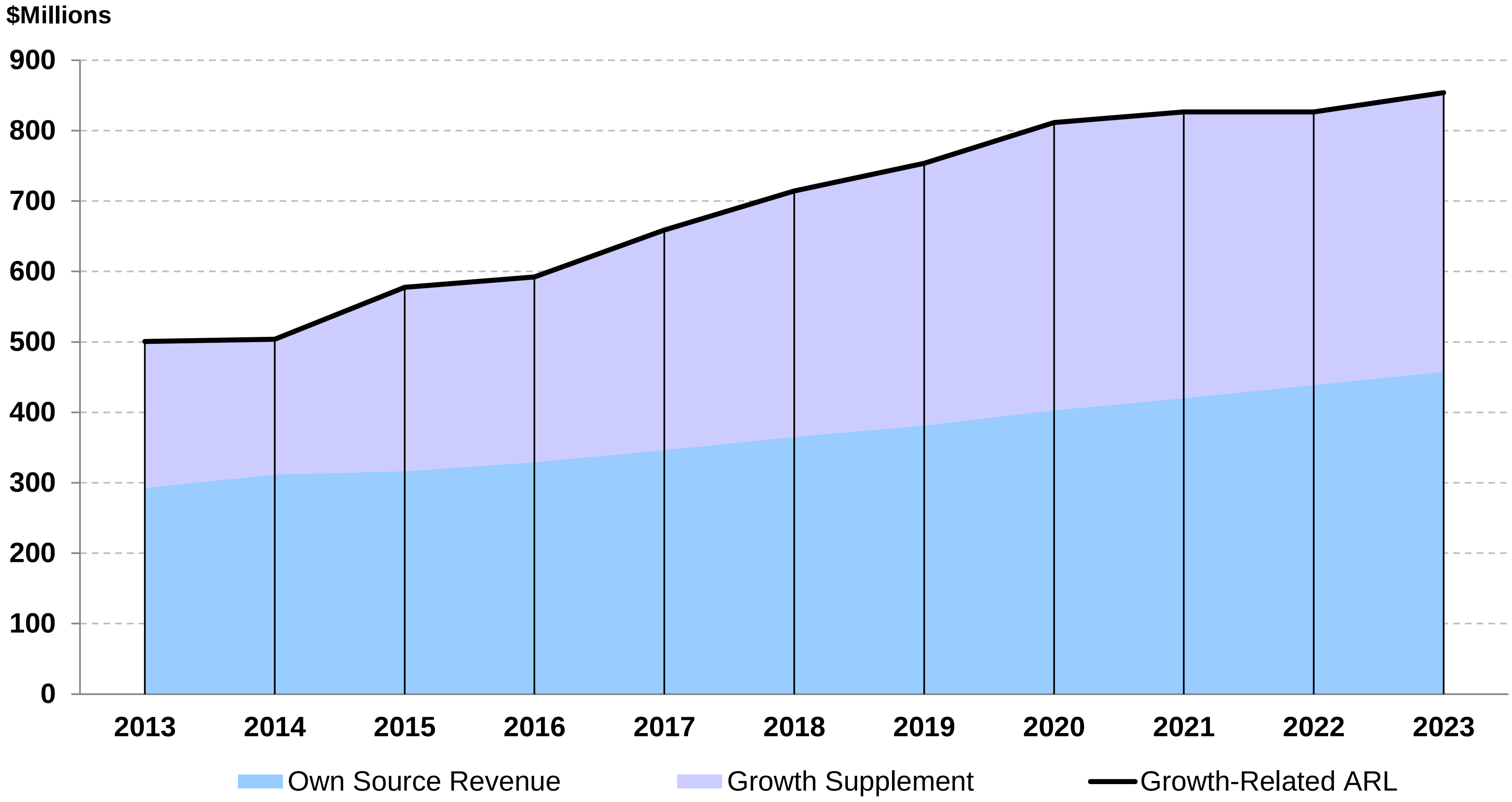
Required Council Considerations When Adopting or Affirming a Long-Term Debt Management Plan

- Long-term debt needs over a multi-year period compared to the growth-related ARL for each year
- Risks and mitigation strategies associated with the Long-Term Debt Management Plan
- Compliance with the Region’s Capital Financing and Debt Policy
- Estimated needs during the fiscal year for temporary borrowing
- Evaluation of prior year (2013) outcomes

Forecast of Long-Term Debt to be Issued



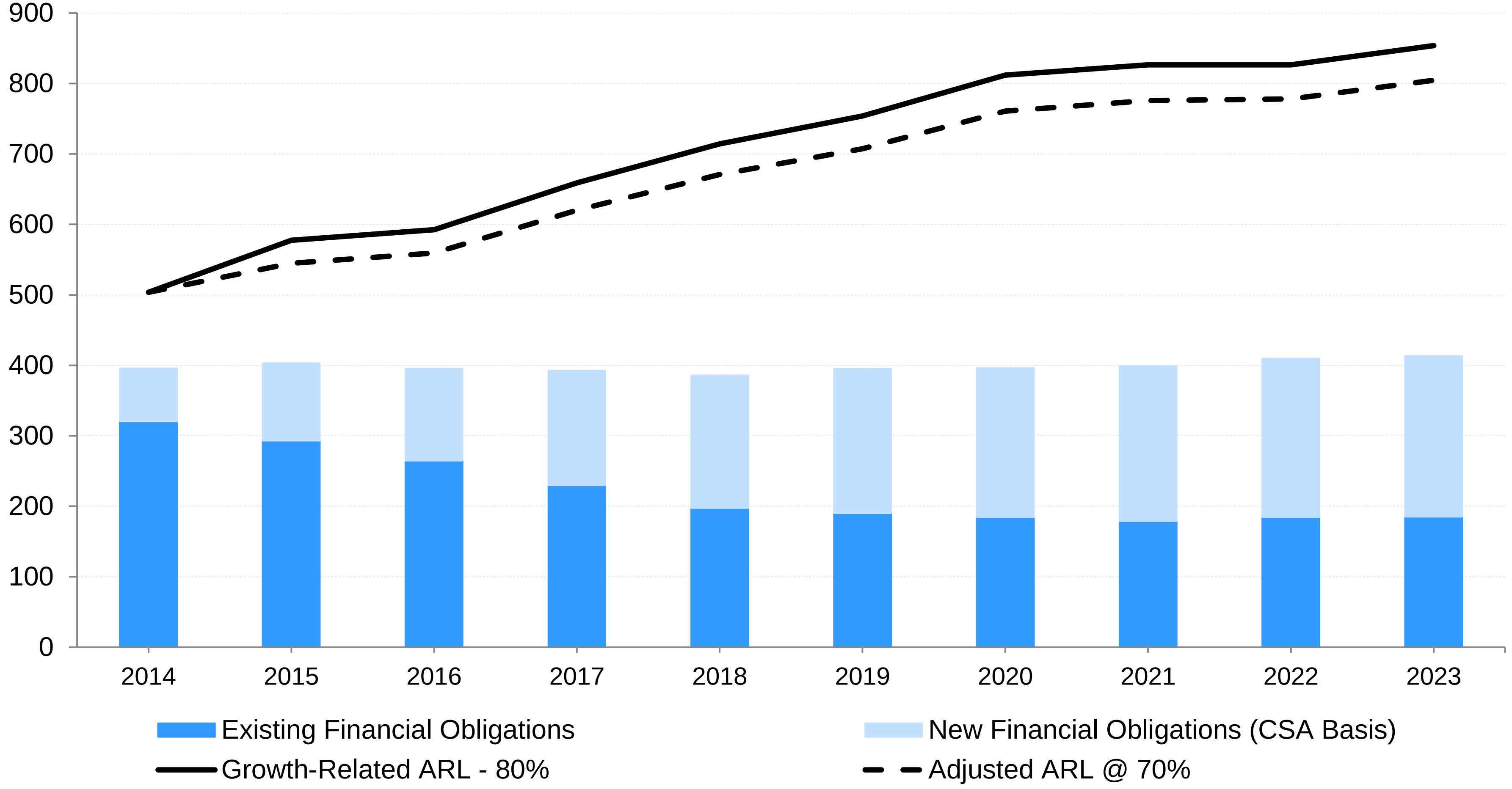
ARL Determined as 25% of Own Source Revenue Plus a Growth-Related Cost Supplement



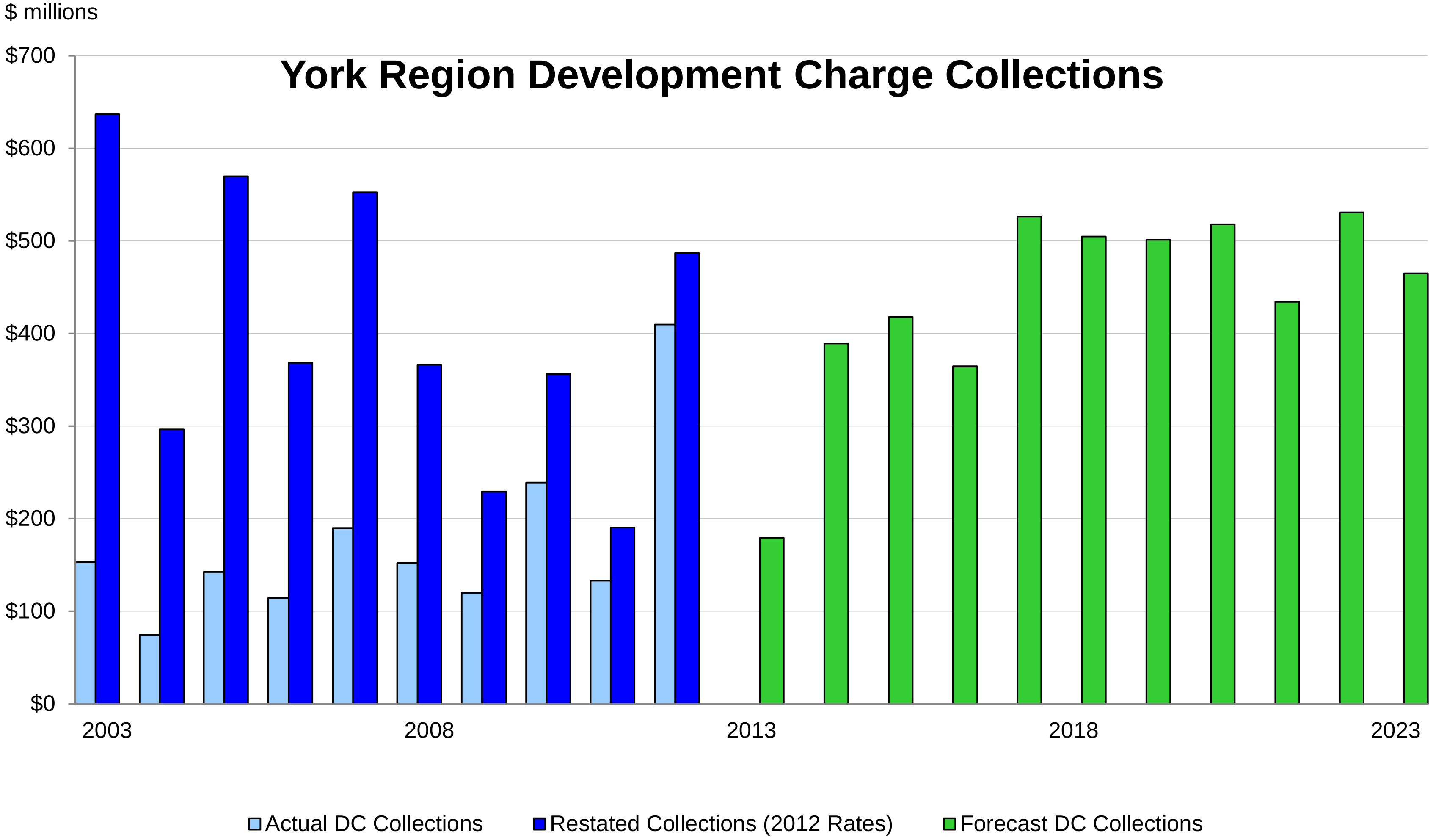
Calculation of the Region's ARL for 2014

Component ($Millions)	Forecast 2014
Step 1:	
Property Taxes/PIL's	847
User Rates – Sewer/Water/Solid Waste	221
Transportation User Fees	52
Other User Fees	33
Provincial Fines	10
Other Revenue	84
Total Own Source Revenue	**1,247**
25% of Own Source Revenue	**312**
Step 2:	
DC Collections (3-year rolling average)	240
DC Cost Supplement (80% of 3-year rolling Average)	**192**
TOTAL ARL (Step 1 + Step 2)	**504**

The Region Is Well Within Its ARL Over The Forecast Period



DC Collections Support Debt Repayment



Risks Associated With DC Collections Have Been Mitigated

- Council policy is to budget using only 70% of the forecasted 3-year average of DC collections versus the 80% permitted, except where specific Council approval is obtained to do otherwise

- Capital plan was measured against an adjusted ARL to help mitigate against lower-than-expected DC collections

- The 2013 DC collections are tracking on budget, so the 2014 ARL has been calculated based on the full cost supplement permitted (i.e., 80%)

Other Risks And Their Mitigation Strategies

- Interest rate increases (after 2014/15) – Plan assumes 5.00%, rising to 6.25% by 2019
  - Use of pre-borrowing and bond forward agreements
- Ability to access financial markets
  - Use of back-up credit facilities (i.e., Infrastructure Ontario), temporary use of reserves, limitations on refunding debt, and Investor Relations Program
- Higher than anticipated capital costs due to scope changes, overruns, inflation, and non-budgeted expenses
  - Prioritization of projects during annual budget process and careful monitoring of project capital costs

Additional Risk Mitigation Strategies

- Maintaining high investment returns on reserves to lower future reliance on debt

- Ensuring efficient debt issuance to maintain lowest costs possible

- Further refinement of development charge forecasting model

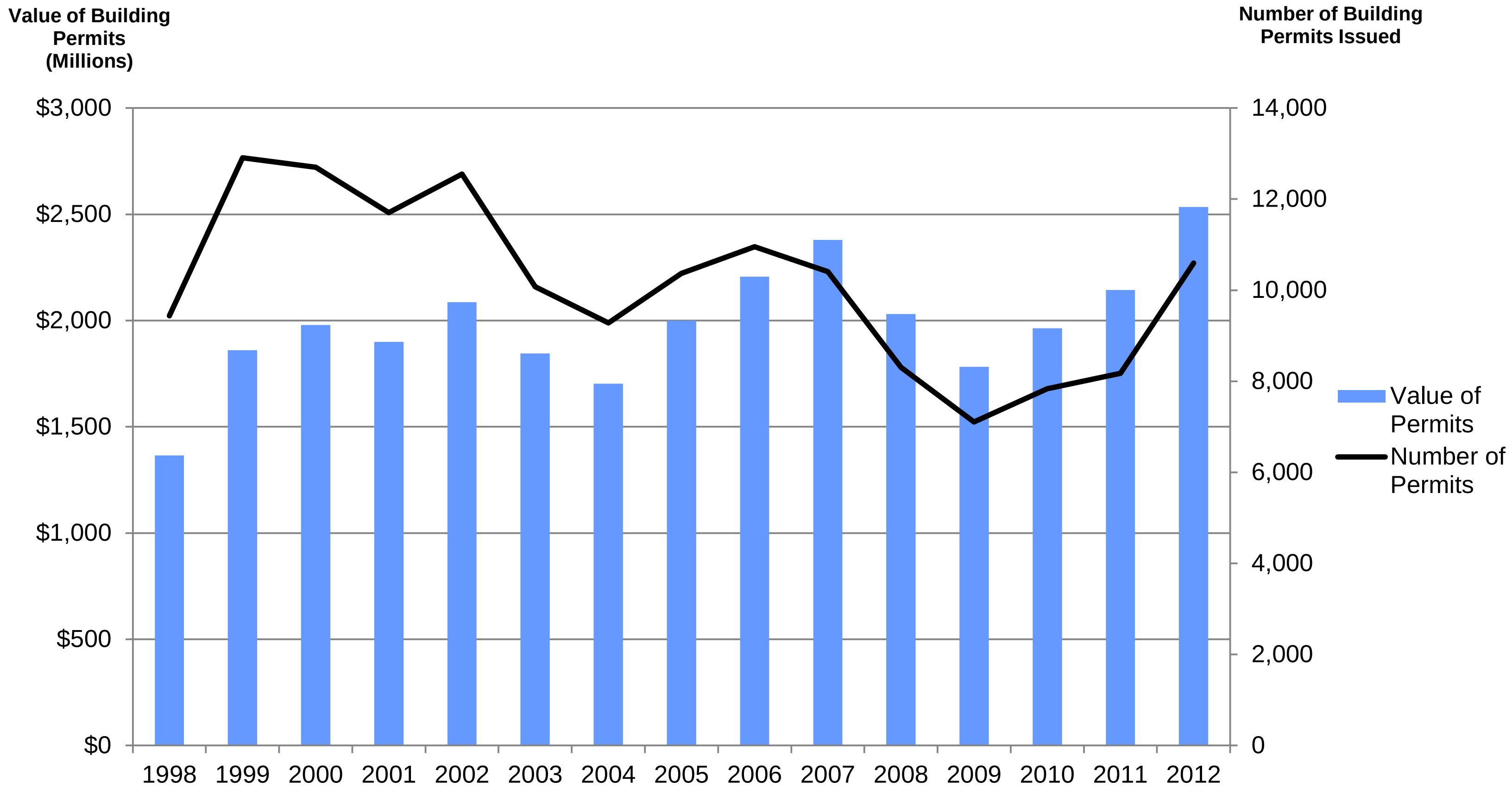
Reserves Are Also Critical For Risk Mitigation

- Credit rating agencies evaluate liquidity and consider reserves as an indicator of fiscal prudence. High liquidity supports the maintenance of a superior credit rating, which results in lowest borrowing costs possible

- The Region maintains minimum DC reserve balances to help offset lower-than-expected DC collections in any given year

- The Region utilizes a number of different non-growth reserves that can be used to fund DC-related projects on an interim basis if needed

Mitigation Strategies Have Proven Effective



During the 2008-09 financial crisis, the Region did not issue debt for 19 months and used reserves for capital investment

Capital Financing and Debt Policy Underpins The Long-term Debt Management Plan

- Guides borrowing decisions
- Covers all financial obligations entered into by the Region and establishes objectives, standards of care, authorized financing instruments, reporting requirements, and responsibilities in order to ensure that financing needs are addressed as effectively as possible
- Policy is under constant review to identify and incorporate best practices in the municipal field
- Policy last updated and approved by Council in 2011

Temporary Borrowing Needs Arise Due to Timing Differences

- Delay in receipt of taxes and other revenues results in short-term funding gap for operational expenditures

- In any given year, interim funding will be required for capital asset expenditures until long-term financing is in place (i.e., spring and fall debenture issues)

- Province limits the amount of temporary funding to 50% of budgeted total revenue from January to September and 25% from October to December

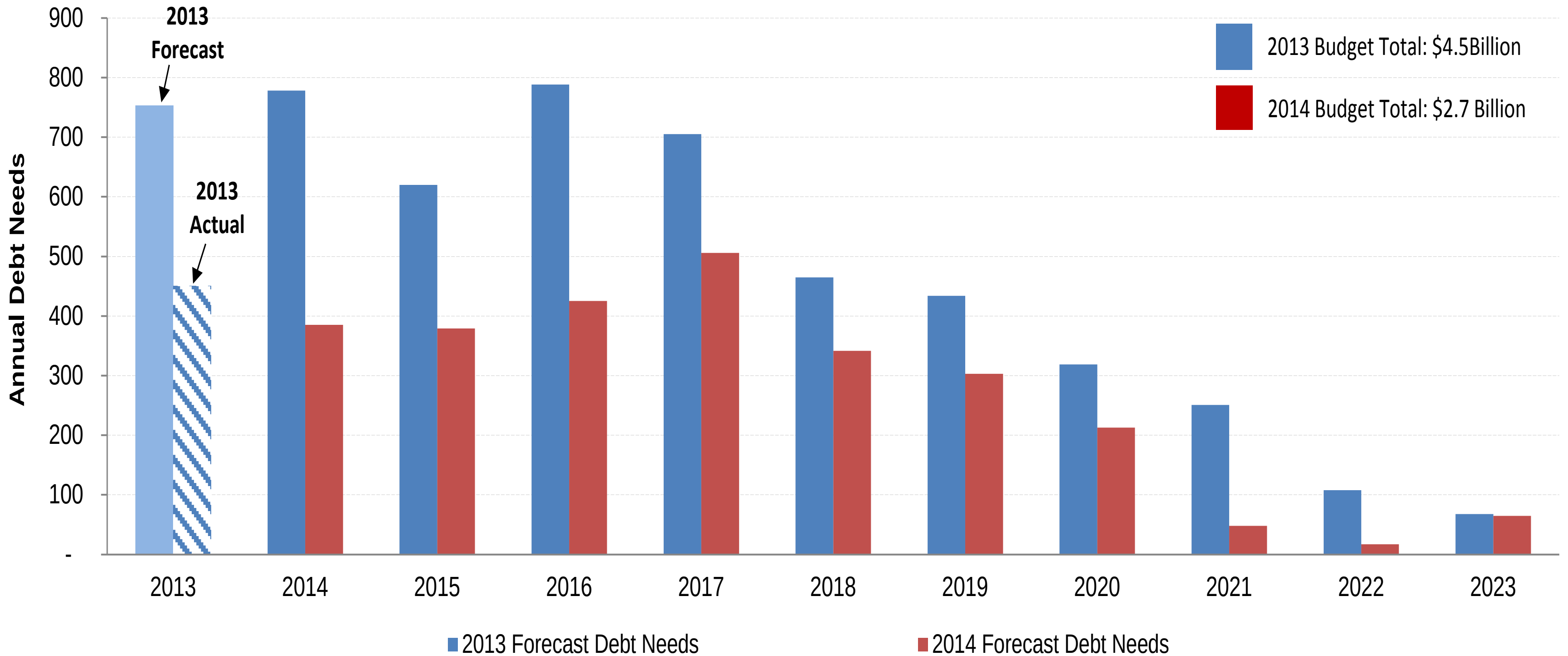
- For 2014, the Region’s temporary borrowing needs are estimated at $325 million for operating and $350 million for capital, and are well within the Provincial limits

The Region Was Fully Compliant with its ARL in 2013

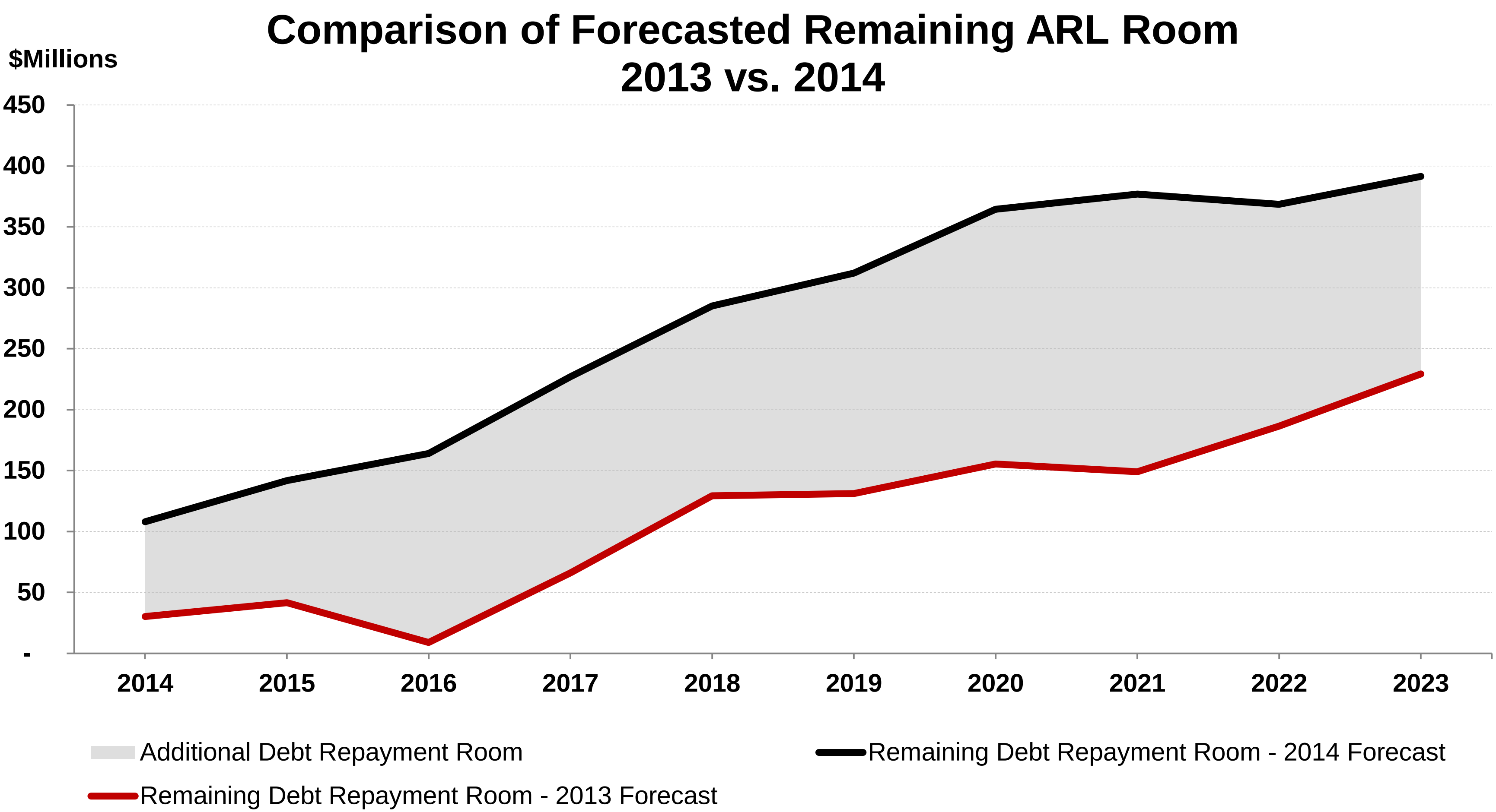
Component ($Millions)	Forecast	Actual	Difference
25% of Own Source Revenue	293	293	-
Plus: Growth Cost Supplement	182	208	26
Total ARL	**475**	**501**	**26**
Less: Existing Financial Obligations	298	295	(3)
Less: Anticipated New Financial Obligations	154	154	-
Remaining ARL (>0)	**23**	**52**	**29**

2014 Debt Plan Reduces Debt Requirements Over The Next 10-years

Comparison of Debt Needs (CSA Basis)
2013 Budget vs. 2014 Budget
2013-2022
($Millions)



New Policies Have Substantially Increased ARL Room



Summary of the Debt Management Plan

- The Long-Term Debt Management Plan addresses the matters Council must consider:
  - Anticipated long-term debt needs will be within the Region's ARL over the 10-year forecast period.
  - Risks of the debt management plan have been identified and mitigation strategies are in place.
  - Temporary borrowing needs are well within Provincial limits.
  - The Region is compliant with its Capital Financing and Debt Policy.
  - The 2014 Debt Management Plan requires substantially less debt than previously anticipated.
  - The Region was within its ARL during 2013.

- Staff will continue to assess the long-term implications of the ARL methodology as outlined in the Regulation