

Policy

Title: DEBT MANAGEMENT POLICY		Number: 0176
Reference: Administrative Committee - February 23, 2023 Audit Committee - March 1, 2023	Adopted by City Council: March 6, 2023	
	City Clerk	City Manager
Supersedes: Policy 0121		
Prepared by: FINANCE DEPARTMENT, CORPORATE SERVICES DIVISION		

STATEMENT

THE CITY OF MEDICINE HAT (THE CITY) UTILIZES DEBT IN ITS COMMITMENT TO MANAGE ITS FISCAL POSITION IN A PRUDENT AND SUSTAINABLE MANNER, AS WELL AS BALANCE THE NEED FOR CAPITAL INFRASTRUCTURE AND THE ABILITY TO PAY FOR IT.

PRINCIPLES

1. Debt is an ongoing component of the City's financing structure and is integrated into the City's long-term plans and strategies.
2. Debt must be structured in a way that is fair and equitable to those who pay and benefit from the underlying financed assets over time.
3. Debt shall be undertaken and administered in accordance with all applicable law including, without limitation, the Municipal Government Act, including all applicable regulations thereunder, this Policy, the Procedures and all other applicable bylaws, policies and procedures of the City.
4. Debt may be obtained via debentures or other forms of financing necessary to meet the City's infrastructure and operating requirements as prescribed by the relevant sections of the *Municipal Government Act* (the "MGA") *RSA 2000 Chapter M-26*, namely those related to "Borrowing" (section 251 to 263) and "Loans and Guarantees" (section 264-268), including any subsequent amendments and the applicable regulations thereunder.
5. The *Debt Management Policy* guides the rationale and processes that govern the City's borrowing as it pertains to the overall levels of indebtedness, the structure of the debt, as well as the annual debt servicing limits.
6. The issuance of new debt must be approved by City Council and authorized by adopting a borrowing bylaw.
7. Debt must be managed, monitored, and reported upon.

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ROLE OF COUNCIL

1. To receive, review and adopt this policy and any recommended amendments thereto.
2. To approve capital and operating budgets incorporating anticipated debt requirements.
3. To approve borrowing bylaws for the issuance of new debt.

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1. DEFINITIONS

- 1.01 Authorized Debt: Council approved debt financing as a source of funding.
- 1.02 Capital Financing: A generic term for the financing of capital assets. This can be achieved through a variety of sources such as tax levy, grants, reserve funds and debt.
- 1.03 Capital Expenditures: Expenditures incurred to acquire, develop, renovate, or replace capital assets as defined by Public Sector Accounting Board section 3150.
- 1.04 Capital Infrastructure: An asset that provides a benefit to the City in excess of one year (i.e., construction, purchase or restoration of major facilities, roadways, bridges, storm sewers, sidewalks, curbs, and gutters).
- 1.05 Capital Plan: The approved budget for capital projects (i.e., the expenditures and resources required for capital projects) as well as long-term capital estimates and forecasts incorporated in the City's long-term plans and strategies.
- 1.06 Debenture: A formal written obligation to pay specific sums on certain dates. In the case of a municipality, debentures are typically unsecured (i.e., backed by general credit rather than by specified assets).
- 1.07 Debt Limit: Per *Municipal Government Act*, the legislated debt limit is calculated as 2.0 times revenue of the Municipality as defined in Alberta Regulation 255/2000 and any amendments thereto. Referred to as 100% of allowable debt limit.
- 1.08 Debt Management Policy: Refers to this document.
- 1.09 Debt Program: Refers to the practices related to authorizing debt, issuing debt and monitoring debt. For example, part of the debt program includes issuing debt and the particulars related to issuing debt specifically the amount, timing, and structure of the issuance.
- 1.10 Debt Servicing Costs: Annual principal and interest amounts owing on outstanding loans made by the Municipality plus annual principal and interest amounts that the Municipality will be liable to pay on loans guaranteed by the Municipality.
- 1.11 Debt Servicing Limit: Per the *Municipal Government Act*, the legislated debt service limit is calculated at 0.35 times revenue of the Municipality as defined in Alberta Regulation 255/2000 and any amendments thereto.
- 1.12 Debt Repayment: The regular and/or special repayment of debt principal that has been incurred to finance City projects.
- 1.13 Debt Term: The period of time during which debt payments are made. At the end of the debt term, the debt is paid in full.
- 1.14 External Debt: Includes any type of financing obligation to a third party, secured by the credit of the City.

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- 1.15 Growth Project: A capital project that will expand the productive capacity of the City's pre-existing operations.
- 1.16 Intergenerational Equity: In economic, psychological, and sociological contexts, is the concept or idea of fairness or justice between generations.
- 1.17 Internal Borrowing: Borrowing from City reserves to finance projects. When an internal borrowing occurs, it is planned that the reserve is repaid the principal amount borrowed plus interest.
- 1.18 Internal Debt Limit: The City's internal limit on debt as a percentage of the provincial authorized Debt Limit per Municipal Government Act (100%).
- 1.19 Lease Financing Agreement: A financial lease agreement for the purposes of obtaining long term financing of a capital undertaking of the municipality. For example, leasing of equipment.
- 1.20 Letter of Credit: A binding document from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make payment on the purchase in accordance with the agreed terms and conditions, the bank will be required to cover the full or remaining amount of the payment).
- 1.21 Lifecycle Renewal Project: A capital project for the rehabilitation or renewal of existing infrastructure due to obsolescence, health and safety concerns, or general deterioration of assets related to use or age.
- 1.22 Loan Guarantee: An agreement whereby the City will take responsibility for the payment of debt in the event that the primary debtor fails to perform.
- 1.23 Long-term Debt: Debt obligations that are typically issued for capital expenditures. In the case of the City, this is usually in the form of a debenture varying in debt terms but not exceeding 40 years in length.
- 1.24 Operating Debt: Consists of all short-term liabilities that the City incurs through its primary business activities and whose source of payment is the City's operating revenues.
- 1.25 Operating Debt Limit: Per the Municipal Government Act, the amount of operating debt must not exceed the amount the City estimates will be raised in taxes in the year the borrowing is made.
- 1.26 Reserves: Money that has been specifically set aside by City Council to fund future expenditures, which are either operating or capital.
- 1.27 Revenue: Annual revenue as published in the last audited financial statements of the City which includes revenues from taxes, sales of services, utilities, user fees, departmental and corporate programs, developer and customer contributions, and Boards and Authorities.

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- 1.28 Service Improvement Project: A capital project that provides a new or expanded level of service to the municipality or enhances an operational service area.
- 1.29 Short-term Debt: Debt obligations that are used to cover interim or bridge financing of capital expenditures. In the case of the City, short-term debt may be in the form of internal borrowing, line of credit, or debenture debt with a repayment term of 2 years or less.
- 1.30 Sustainable: Meeting present needs without compromising the ability to meet future needs.
- 1.31 Tax Supported Debt: Debt that has been issued for funding of expenditures relating to tax supported operations. The debt is repaid using tax levy revenues.
- 1.32 Utilities: Self-funded operations providing a service to its customers, including a return on investment, at rates regulated by City Council. These utilities are Natural Gas Petroleum Resources, Gas Distribution, Electric Generation, Electric Distribution, Water, Sewer, and Solid Waste.

2. RESPONSIBILITIES

- 2.01 City Council
 - (a) Receive, review, and adopt this policy and any recommended amendments thereto.
 - (b) Approve capital and operating budgets incorporating anticipated debt requirements.
 - (c) Approve borrowing bylaws for the issuance of new debt.
- 2.02 Administrative Committee
 - (a) Approve procedures relating to funding of capital and operating activities.
 - (b) Perform an internal review of operating and capital budgets and provide direction to departments to make changes as required to meet objectives of Council.
- 2.03 Managing Director, Corporate Services/CFO
 - (a) Direct the capital and operating budget process.
 - (b) Recommend optimal financing sources for capital and operating projects.
 - (c) Review and approve the timing of drawdowns of external debt.
- 2.04 Financial Control & Reporting Department
 - (a) At the direction of the Managing Director, Corporate Services/CFO, prepare the annual operating and capital budget instructions, disseminate same and liaise with all departments to ensure that budget preparations are in accordance with procedures and policies directed and approved by City Council. After the Administrative Committee review, prepare the final budget documents for review and adoption by City Council.

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2.05 Treasury Department

- (a) In conjunction with Financial Control & Reporting, provide the recommended funding source for capital and operating projects to the Managing Director, Corporate Services/CFO.
- (b) Initiate borrowing bylaws and the setting in place of all Provincial and other approvals, prior to undertaking capital activities funded by external debt sources. The Department requiring the debt is responsible to ensure that such approval is obtained prior to entering into any agreement for fabrication of structural components or for construction at the site of the work or undertaking described in each bylaw.
- (c) At the direction of the Managing Director, Corporate Services/CFO, be responsible for approved external long-term borrowing and coordinating with external lenders.
- (d) Record all outstanding debt acquired and update all debt schedules.
- (e) Disburse annual payments of principal and interest to meet repayment schedules provided by lenders.
- (f) Annually reconcile outstanding debt and debt payments. Provide audit confirmation as required.
- (g) Annually prepare journal vouchers to charge each department with its appropriate debt charges.
- (h) Annually prepare projections of subsequent year's debt charges (principal and interest) to be used by each department in preparation of their operating budget. This schedule will be provided to Financial Control & Reporting for insertion in the budget instructions.

3. PURPOSE

- 3.01 The purpose of the Debt Management Policy is to outline objectives, standards, and appropriate controls for the use and issuance of debt, and to ensure that the City's financial conduct is governed by the following:
- (a) The City utilizes debt prudently and efficiently in accordance with best practice as applied in the context of municipal fiscal policy and treasury management. This includes, but is not limited to, the following considerations:
 - i. Identify sources of funding for debt repayment when debt is issued
 - ii. Aligning with the City's planning and budgeting process and longer-term financial considerations
 - iii. Ensuring appropriate guidelines and controls are in place for both issuance and use of debt
 - iv. Minimizing the long-term cost of financing
 - v. Considering the use of debt in the context of other forms of financing, generally as the last applied form of financing.
 - vi. Limiting financial risk exposure and applying appropriate risk mitigation strategies
 - vii. Fulfilling all relevant provincial and federal legislative requirements
 - viii. Adhering to transparent and reasonable reporting requirements
 - ix. Ensuring the City has sufficient debt capacity available to provide for financial flexibility by appropriately managing the timing of cash flows in both short-term and longer-term horizons.

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4. OBJECTIVES

4.01 Adherence to statutory requirements

- (a) The City shall secure temporary or long-term borrowing necessary to meet the City's infrastructure and operating requirements only if, and when, the City is in compliance with the relevant sections of the MGA, namely those related to "Borrowing" (section 251 to 263) and "Loans and Guarantees" (section 264-268) and related regulations. These requirements include, but are not limited to:
 - i. Section 252(1) of the MGA, and subsequent Debt Limit Regulation A.R. 255/2000, as amended, the Debt Limit for the City of Medicine Hat
 - a. in respect to the municipality's total debt is 2.0 times the revenue of the municipality.
 - b. in respect to the municipality's debt service is 0.35 times the revenue of the municipality.
 - ii. Section 256(2) of the MGA, the amount of operating debt must not exceed the amount the municipality estimates will be raised in taxes in the year the borrowing is made.

4.02 Intergenerational equity

- (a) The City shall structure debt financing in a way that is fair and equitable to those who pay and those who benefit from projects over time.

4.03 Managing long-term cost of financing

- (a) The City shall ensure that the debt program uses a systematic approach that minimizes the impact of debt servicing costs.

5. FINANCIAL GUIDELINES

5.01 Categories of Debt

- (a) Internal Borrowing
- (b) External Debt, which may include, but is not limited to, the following:
 - i. Operating Debt
 - ii. Short-term Debt
 - iii. Long-term Debt

5.02 Debt Issuance

- (a) Internal Borrowing
 - i. Where the City's reserve position allows, and based on cash flow analysis, the City may use internal borrowing to fund capital projects in order to reduce overall net borrowing costs.
 - ii. Where the City chooses to internally borrow, a financing rate shall be applied to funds required to offset the capital project expenditures to date. The rate used shall be the Province of Alberta rate, applicable to the appropriate term of the loan, at that point in time and will be credited to the City's interest income account on an annual basis. This interest rate is intended to offset the investment earnings not earned or lost by the City on funds utilized to interim finance capital projects.
 - iii. While not formal debt, the use of the City's reserves to finance capital projects must be carefully managed to ensure liquidity in meeting operating cash requirements.

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- iv. All internal loans will have amortization schedules for repayment with terms not exceeding 30 years and under no circumstances can exceed 90% of the expected useful life of the project. There is no penalty for early repayment and internal loans will not be refinanced under normal circumstances.
- (b) Operating Debt
 - i. Operating Debt may include, but is not limited to, the following:
 - a. Overdraft Protection/Line of Credit
 - b. Bankers' Acceptance
 - c. Letters of Credit
 - ii. The use of operating debt must be carefully managed to ensure the City remains in line with Section 256(2) of the MGA, the amount of operating debt must not exceed the amount the municipality estimates will be raised in taxes in the year the borrowing is made.
 - iii. When cash deficits are forecasted for a few days, cash requirements may be funded by way of overdraft facilities with the City's bank. When timing gaps between expenditures and receipt of revenues are forecast for longer periods the City may issue bankers' acceptances, or other forms of short-term borrowing in order to provide additional liquidity and effective cost of funds.
 - iv. In lieu of providing cash deposits to a beneficiary of the City, Letters of Credit may be issued as a form of security to guarantee payment at a future date.
- (c) Short-term Debt
 - i. Short-term debt may be used as interim or bridge financing for capital expenditures. The term of the debt repayment is not to exceed 2 years. Short term debt may be in the form of internal borrowing, line of credit or debenture debt with a term of two years or less. All external short-term borrowing shall be subject to adoption of required borrowing bylaws.
 - ii. Short term debt will not be used for emergency funding, current operating expenses, or exchange rate protection. If required, these would be funded through reserves or operating debt.
- (d) Long-term Debt
 - i. Long-term debt may include, but is not limited to, the following:
 - a. Debentures
 - b. Public-Private Partnerships
 - c. Loan Guarantees
 - d. Lease Financing Agreements
 - ii. Prior to any proposed borrowing, a needs analysis and a fiscal impact analysis shall be completed on each identified project.
 - iii. The City may incur and carry long-term debt only to support priority capital projects pursuant to approved Capital Plans and resulting capital budgets and/or emergent needs.
 - iv. The City may borrow by debenture, conventional bank financing or other approved financing debt instruments to finance the construction, purchase, or major restoration of facilities and infrastructure. The projects shall appear in the approved Capital Budget or as otherwise approved by Council.

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- v. Existing reserves may be used as a source of internal borrowing in lieu of external debt. When internal borrowing is used, the reserves shall be repaid with interest as specified above in the Internal Borrowing section. If sufficient funds are not available in reserves to provide long-term financing, then the Province of Alberta may be used as the lender of choice. Where it is more attractive and advantageous (considering factors such as penalties for early repayment and other considerations), a longer-term financing arrangement with another acceptable lender may be considered. Upon approval by Council, specific reserves may be utilized to provide debt servicing for long-term debt with no expected repayment provisions.
- vi. Long-term debt may be considered for capital expenditures for municipal or utility purposes where the expected asset life, or increase to asset life, is greater than five years and a valid project charter has been established for the capital project.
- vii. The repayment term (amortization) in respect of long-term debt shall not exceed 90% of the estimated useful life of the asset being financed by the City; however, in order to minimize borrowing costs, the term shall be minimized.

5.03 Debt Terms

- (a) The term of any debt for capital assets shall not exceed the useful life of the asset being financed.
- (b) Short-term debt issued for interim or bridge financing for capital expenditures shall not exceed a repayment term of 2 years.
- (c) Long-term debt issued for capital financing shall not exceed 40 years unless approved by Council.
- (d) The following elements should be considered when establishing the debt term:
 - i. Cost minimization
 - ii. Availability of debt servicing funding
 - iii. Fair distribution of costs between periods
 - iv. Capital life cycle implications
 - v. Sustainability
 - vi. City's financial flexibility

5.04 Early Repayment of Debt

- (a) The City will take advantage of opportunities to retire outstanding debt early, where financial analysis suggests cost savings and where funds are available to accommodate early retirement. High interest, tax supported debt is given priority consideration for debt repayment.

6. STATUTORY AND INTERNAL LIMITATIONS

6.01 Limiting Authorized Debt

- (a) The City shall limit the amount of debt authorized on an annual basis by applying debt financing to projects in the capital plan in a manner consistent with the following:
 - i. Debt financing may be utilized as a source of funding for growth projects;
 - ii. Debt financing may be utilized as a source of funding for sustaining and service improvement projects after all other funding options have been applied and exhausted; and

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- iii. Debt financing shall only be authorized as a source of funding for lifecycle renewal projects after all other funding options have been applied and exhausted
- (b) The Managing Director, Corporate Services/CFO shall have the authority to change the above application of debt financing as a source of funding for projects in the capital plan prior to capital plan and funding sources being approved by Council.
- (c) The City shall adhere to the Debt Limit prescribed by the MGA as defined in Alberta Regulation 255/2000 and any amendments thereto. The Debt Limit established for the City of Medicine Hat is 2.0 times the revenue of the municipality.
- (d) The City shall further limit debt financing as a source of funding in the capital plan by way of an Internal Debt Limit:
 - i. The City shall not exceed 70% of the Debt Limit per MGA
- (e) The Administrative Committee shall have the authority to set and modify the internal debt limit such that the internal debt limit meets the City's long-term financing strategies and does not contravene the MGA or provincial regulations thereunder.
- (f) The City shall also adhere to the Operating Debt Limit prescribed by the MGA:
 - i. The amount of operating debt must not exceed the amount the municipality estimates will be raised in taxes in the year the borrowing is made.

6.02 Minimizing Risk Associated with Issuing Debt

- (a) The City shall not issue long-term financing on capital projects until they are substantially complete, or a significant milestone is achieved.
- (b) The timing and amount of debt issued in a given year shall be at the discretion of the Managing Director, Corporate Services/CFO after consideration of cash flow requirements, budget constraints, and market conditions. This discretion must be exercised in accordance with the MGA and the regulations.
- (c) The City's general practice shall be to issue debt that is denominated in Canadian dollars with fixed interest rates over the term. Notwithstanding, if a borrowing structure is presented for which there is a material financial advantage and/or it is deemed prudent for the City to issue debt that is subject to interest rate fluctuations, the City may, at the discretion of the Managing Director, Corporate Services/CFO consider entering into this type of arrangement. Variable interest rate structures or the use of Derivatives may be considered.
- (d) Derivatives may be used insofar as they facilitate achieving a specific financial objective consistent with the *Debt Management Policy*, and if deemed prudent and in the City's best interest as determined by the Managing Director, Corporate Services/CFO. They are to be considered as an interest rate management tool in instances when they could facilitate the hedging of risk or achieving significant cost savings as compared to a non-derivative financial instrument. For instance, in certain cases the City may wish to consider issuing debt with a variable interest rate. To mitigate associated interest rate risk, the City may consider entering into an interest rate exchange agreement that would effectively alter the pattern of debt service payments or cap the variable rate at a predetermined level. Alternatively, were the City to issue Debt denominated in a foreign currency, entering into a foreign currency exchange agreement should be considered to convert the obligation to Canadian currency.

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- (e) Temporary financing instruments may be issued either for operating or capital purposes. Temporary financing for amounts that the City considers necessary to meet the expenses during the current fiscal year until the receipt of taxes and other revenues shall be in accordance with Section 256(2) of the MGA and the temporary borrowing by-law passed by Council.

6.03 Minimizing Debt Service Costs:

- (a) The term of long-term financing shall not extend beyond 90% of the estimated lifetime of the capital project for which the debt was incurred and shall not exceed 40 years unless approved by Council. The term preference as well as the structure of long-term financing instruments will be at the discretion of the Managing Director, Corporate Services/CFO and subject to the requirements of the MGA.
- (b) The City shall monitor debt servicing costs and annual repayment amounts to ensure compliance with the Debt Servicing Limit prescribed by the MGA as defined in Alberta Regulation 255/2000 and any amendments thereto. The Debt Servicing Limit established for the City of Medicine Hat is 0.35 times the revenue of the municipality.
- (c) The City shall also utilize other benchmarks, measures, indicators, ratios, and limits as determined relevant and appropriate by the Managing Director, Corporate Services/CFO to monitor debt levels and servicing costs.

7. REPORTING

- 7.01 In addition to any information requested by Council, or any information that the Managing Director, Corporate Services/CFO considers appropriate, the following shall be reported to Council:
- (a) The status of issued and authorized debt as well as debt servicing costs through the budget monitoring reports.
 - (b) Projections for debt levels and debt servicing costs through the budget process
 - (c) Debenture issuances.