Policy GP-029 Debt Management Policy

Governance Policy GP-029	Section: Financial Planning and Reporting
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Policy Statement

Purpose

The purpose of this policy is to establish a comprehensive framework for the issuance and management of debentures and other forms of debt financing by Norfolk County, in alignment with the applicable provisions of the *Municipal Act, 2001* and its regulations, as amended. This policy ensures that all borrowing activities are conducted in a fair, transparent, and fiscally responsible manner, supporting the County's long-term financial sustainability objectives. This policy also outlines strategies for managing debt in a way that preserves the County's financial strength, promotes long-term sustainability, and upholds a strong credit profile. It sets guiding principles and limitations to ensure that debt usage supports service delivery without compromising operational flexibility or placing undue burden on future generations.

Scope

This policy applies to the issuance, management, and monitoring of all debt obligations undertaken by Norfolk County. It governs both existing obligations and any future debt or financing arrangements considered. All County staff involved in debt-related activities must adhere to the provisions of this policy. It must be referenced when evaluating any new debt proposals to ensure alignment with legislative requirements, principles of prudent financial management, and the County's long-term financial sustainability objectives.

Principles

The general principles which will guide the County's management of debt financing in accordance with this policy, in priority order, are as follows:

<u>Adherence to Legislative Requirements</u>

It shall be the County's practice to undertake borrowing in a form that meets all legislative requirements. The County may only borrow if in compliance with the *Municipal Act, 2001*, specifically *Part XIII Debt and Investment*, and its regulations, as amended, and will abide by all applicable legislative requirements. Some of those legislative requirements include:

- Section 401(1) a municipality may incur a debt for municipal purposes…and may issue debentures and prescribed financial instruments and enter prescribed financial agreements for or in relation to the debt.
- 401(4)(b) The Lieutenant Governor in Council may make regulations prescribing debt and financial obligation limits for municipalities, including prescribing the amount to which the debts, financial obligations and liabilities of a municipality… shall be limited.
- Section 408(3) the term of a debt…shall not exceed 40 years.
- Section 408(4) a debenture by-law shall provide for raising in each year as part of the general [levy]…the amounts of principal and interest payable in each year

under the by-law to the extent that the amounts have not been provided for by other taxes or user fees.

- Section 413(1) money received by a municipality from the sale of debentures… shall be applied only for the purposes for which the debentures were issued.

Maintaining Financial Strength

The existence of excessive debt obligations can reduce Norfolk County's financial strength and flexibility over the long-term. To mitigate this risk, the County shall apply thorough financial planning and debt management practices to ensure debt levels remain affordable, responsible, and aligned with its strategic priorities. Borrowing decisions must consider the impact on key financial indicators, including the Annual Repayment Limit (ARL), debt servicing costs, and future funding needs. All debt issuance decisions must not jeopardize long-term financial flexibility and sustainability for the County, and balance current needs with the ability to respond to emerging financing requirements over time.

Norfolk County shall strive to maintain a strong credit rating of AA/Stable at minimum, recognizing that a strong credit profile supports efficient access to capital markets, minimizes borrowing costs, and satisfies statutory requirements for certain financing arrangements. The County should strive to strengthen its credit rating with the goal of reaching the AAA rating, which is the strongest investment grade the rating agency assesses. This can occur through institutional and economic improvements to municipal governments or improvement in the County's financial management, budgetary performance, liquidity, or debt burden indicators.

Ensuring Equitable Use of Debt Financing

Norfolk County shall strive to utilize debt financing in a way that is fair and equitable to those who pay for and benefit from the use of assets and services over time. As such, debt shall be used primarily for the construction of new assets, significant service level improvements, or major enhancements, where the benefits will accrue to future users. By financing new infrastructure through debt, the County ensures that debt servicing costs are repaid over the useful life of the asset by the residents who enjoy its benefits, supporting the concept of equity.

Conversely, the County should strive to avoid the utilization of debt financing as a funding source for the replacement or rehabilitation of existing assets, which would optimally be funded using reserves accumulated over time by contributions made by current and past residents who have benefited from the assets and services over their life.

Additionally, payments for debt obligations must also align with the nature of the project: debt incurred for levy-supported projects shall be repaid through the annual net levy requirement, while debt for rate-supported projects shall be repaid through the annual net rate requirement. This approach ensures that repayment obligations are matched to the appropriate class of taxpayers or ratepayers, maintaining fairness across all County stakeholders.

Not withstanding the above, if borrowing arises from projects driven by meeting growth needs, it should not be repaid by taxpayers nor ratepayers, but instead the stakeholders creating growth. Development charges are forecasted, imposed, collected, and held in reserve funds until applicable infrastructure projects arise that increase servicing related to growth, at which point the charges are drawn from reserve funds to pay for the project. It shall be the County's practice to attempt to appropriately forecast growth requirements so that the need for DC debt does not arise. However, in cases where development charge reserve fund balances are not sufficient to fund a growth-related project that Council deems must commence, it may be the County's practice to issue DC debt, with the respective debt servicing costs paid for by development charge collections.

Mitigating the Long-Term Costs of Borrowing

Debt financing is inherently more expensive than other forms of capital financing due to the interest charges incurred in addition to principal repayments. As such, Norfolk County shall manage its debt program in a systematic and strategic manner that minimizes the long-term financial impact of debt servicing costs. This includes aligning the timing of debt issuances with capital requirements, selecting appropriate terms based on asset life, and assessing market conditions to secure favourable borrowing rates.

Definitions

Amortization Period: The length of time over which a debt is repaid. Also commonly referred to as the term of the financing agreement.

Amortizing Debenture (Amortizer): A type of debenture with equal periodic payments, where the interest portion declines, and the principal portion increases over time.

Annual Repayment Limit (ARL): The maximum amount a municipality is allowed to commit to paying for debt servicing costs on an annual basis, as a percentage of own-source revenues. *Governed by O.Reg. 403/02 Debt and Financial Obligation Limits.*

Approved, Adopted, or Authorized Debt: Debt approved by Council through the Capital Budget process, but not yet issued.

Borrowing Agency: An external financial institution or counterparty authorized to engage in borrowing transactions with the County.

Construction Financing: A short-term financing arrangement used at the start of a capital project to support cash flow during construction. Typically used when immediate significant capital outlays are required prior to long-term debt issuance.

Credit Rating: An independent assessment by a credit rating agency of a borrower's financial strength and risk level, used to inform lenders and investors.

Debenture: A formal written obligation to repay specific sums on designated dates, typically used for long-term borrowing.

Debt: Any financial obligation requiring repayment. For municipalities, this typically includes debentures, promissory notes, and loans from financial institutions, but may also include internal debt financing loans, such as those from reserve funds, as permitted under Policy CS-23 *Reserves and Reserve Funds Policy*.

Debt Servicing Costs: The total annual cost to the County for repaying debt, including both principal and interest components.

Development Charge (DC): Fees collected from developers to fund growth-related infrastructure that supports new development.

Development Charge Debt (DC Debt): A debt obligation repaid through future development charge collections, rather than through general taxation or user fees.

Financial Guarantee: A legal commitment by the County to assume responsibility for a debt if the primary borrower defaults.

Financial Information Return (FIR): A report provided by the Treasurer of a municipality to the Minister annually containing information respecting the financial affairs of the municipality. *Governed by* the *Municipal Act, 2001*.

Infrastructure Ontario (IO): A Provincial crown corporation that acts as one of the primary borrowing agencies for Ontario municipalities.

Internal Repayment Limit (IRL): A debt servicing threshold established by Norfolk County that is more conservative than the legislated ARL, to promote long-term financial sustainability.

Lifecycle Renewal Project: A capital project for the rehabilitation or renewal of existing infrastructure, often referred to as Asset Management Capital.

Limit: A strict upper threshold established by Council or policy that the municipality shall not exceed under any circumstance.

Own Source Revenues: Revenues a municipality generates on its own annually, rather than receiving from other levels of government. *As defined in O. Reg. 403/02: Debt and Financial Obligation Limits.*

Rate-Supported Debt: An obligation for the payment of money, often related to a debenture issued for capital expenditures related to rate funded services, which is to be repaid through the collection of user fees for water or wastewater services through the Rate Supported Operating Budget.

Serial Debenture (Serial): A type of debenture for which each subsequent debt payment is decreasing, with the principal repayment staying the same each payment and the interest payment declining.

Target: A desired or recommended benchmark used to guide financial decision-making and promote long-term financial sustainability.

Tax-Supported Debt: An obligation for the payment of money, often related to a debenture issued for capital expenditures relates to tax funded services, which is to be repaid through the collection of property taxes through the Levy Supported Operating Budget.

Debt Management Practices

Limiting Authorized Debt Based on Project Type

The County shall limit the amount of authorized debt annually in accordance with the principles outlined in this Policy, applying debt financing selectively to projects in the Capital Plan based on the following criteria:

- Debt financing may be used for capital projects that involve the creation of new assets or significant enhancements to existing services or infrastructure.
- Debt financing may be used for growth-related projects where servicing costs can be paid directly by development charge collections for the period covered under the current *Development Charges Background Study*.
- Debt financing may only be applied to lifecycle renewal projects when all other funding sources have been fully explored and exhausted, and where deferral would result in increased risk to the Corporation or unacceptable service reductions to residents.
- Debt financing shall not be used to fund ongoing or recurring costs, or any expenditure that should be included within the annual operating budgets.
- Debt financing shall not be used to fund growth-related projects where repayments would be tied to development charge collections which occur outside of the period covered under the currently in place *Development Charges Background Study* (No Post-Period DC Debt).

Planning and Approval of Debt Requirements

The County shall communicate all anticipated uses of debt in advance of project initiation through its 10-Year Capital Plan. This plan will identify projects recommended for debt financing, and Council's approval of the Capital Plan constitutes approval to proceed with planning those projects using debt as a funding source.

If a project's funding source is amended in a manner that increases the amount of debt required, a separate resolution of Council is required to authorize the revised debt level.

At the time the 10-Year Capital Plan is presented, or any time staff propose increasing debt use on a project, communication must be provided to Council showing the updated impacts on the debt limitations and targets within this policy. This disclosure will help inform responsible and transparent decision-making.

Debt Avoidance

Where feasible, the County shall strive to mitigate the requirements for external financing altogether through the investigation of alternative funding sources. Prior to proceeding with a planned issuance, the County is encouraged to investigate alternative funding sources which can be utilized as opposed to the authorized debt. This would include uncommitted funds within reserves and reserve funds, as well as planning for potential uses of prior-year surplus allocations.

In 2023, the County formalized its Surplus Management Strategy within *Policy CS-23 Reserves and Reserve Funds Policy*. This strategy is implemented in conjunction with the presentation of year end financial statements each year where an operating surplus arises, to determine how to use the funds. According to the strategy, using surplus to reduce the number of projects which are currently approved to be funded by debt is the second priority in order of precedence, after prioritizing a sufficient target balance in the Contingency Reserve. As a result, this acts as a form of mitigation when the Contingency Reserve is sufficient, because the County's next stated priority with excess funds becomes reducing the need to borrow for capital projects.

Ensuring Optimal Debt Structuring Practices

For each of the terms required for a borrowing, the following practices should be considered as forms of mitigation against the long-term costs of borrowing:

- Amounts: The amount of the borrowing should be at a material level that the County cannot self-fund internally within the short-term. Generally, projects which are planned to be funded through debt should be greater than $1,000,000.
- Issuance Timing: The timing of debt issuances should align with optimal cash flow needs and interest rate conditions. While Norfolk County has traditionally issued debt at project completion, larger financing requirements may warrant earlier or staggered issuances.
- Amortization Period: The term of repayments shall not exceed the estimated useful life of the associated asset being financed. For Development Charge Debt, the term shall align with the period over which the corresponding development charges collections are anticipated.
- Borrowing Rates: To ensure cost-effectiveness, staff shall obtain indicative rates from at least two qualified borrowing agencies and proceed with the most advantageous option, unless justified otherwise.
- Payment Frequency: The payment schedule should balance minimizing interest costs with reducing administrative complexity.
- Type: The County shall evaluate the use of serial debentures, amortizing debentures, or other structures. Serial debt is generally preferred due to its lower total interest costs and greater long-term flexibility for debt management.
- Repayment Features: Where feasible, the County is encouraged to negotiate repayment terms that allow for early or partial repayment without penalty, when financially beneficial.

The Treasurer may recommend alternative structuring practices where doing so may improve the County's financial position or administrative efficiency. If non-standard financing structures are pursued, this policy should be reviewed and updated to reflect any new best practices.

Managing Debt Servicing Costs

When debt is approved as a funding source for a project included in the Approved Capital Budget, the County must recognize the resulting debt servicing costs in the applicable operating budget in the year of approval. These future repayment obligations should be forecasted and integrated into the operating budget prior to issuance, ensuring adequate planning and fiscal discipline. For clarity, if a project is approved in 2026 but has a three-year construction period resulting in the anticipated debt issuance taking place in 2029, the projected debt servicing costs should be included in the annual operating budget starting in 2026, not 2029. Debt servicing costs budgeted each year, where the related project has not reached a sufficient level of completion to warrant debt issuance, will be transferred to the appropriate reserve at year-end. The debt servicing costs will continue to be estimated and included in subsequent operating budgets until the issuance occurs.

Prior to each budget cycle, the estimated debt servicing costs for authorized but unissued debt must be recalculated using updated borrowing rate forecasts. This ensures operating budgets reflect the most accurate financial obligations. Additionally, servicing cost budgets for issued debt shall be updated annually based on the repayment schedules established at the time of issuance, ensuring alignment with actual obligations throughout the term of the debt.

As existing debt is retired and/or servicing costs decline, the resulting budget capacity must be redirected to Infrastructure Funding. This practice helps close the infrastructure funding gap and enables the County to increase capital investment levels gradually, without creating pressure on the annual operating levy or rate-supported budgets.

Debt Issuance Practices

To initiate a borrowing process, staff shall prepare a report for Council seeking authorization to apply to a borrowing agency. This report will identify the recommended projects and borrowing amounts, outline the proposed debt structure and terms, and provide an updated forecast of the County’s debt limits/targets. Where feasible, staff should consolidate multiple debt-funded projects into a single report to streamline the approval process and reduce administrative costs.

Upon Council approval, the Treasurer will coordinate the issuance process. This may include the preparation of additional reports, by-laws, and required documentation for Council approval, as stipulated by the borrowing agency or relevant legislation.

Prior to finalizing the borrowing, legal counsel shall be retained to review all documentation and ensure compliance with applicable regulations. Legal services play a critical role in minimizing contractual risks, avoiding administrative errors or penalties, and protecting the County’s interests, such as by holding funds in escrow until all conditions are met.

Debt Limitations/Targets

Norfolk County recognizes the importance of preserving borrowing capacity to support future infrastructure needs and to maintain long-term financial flexibility. The County's annual budget documents shall include forward-looking projections of anticipated debt financing requirements for both tax-supported and rate-supported service areas. These projections enable proactive evaluation of debt capacity in relation to both legislated limits and internal policy targets. Under no circumstance shall a Limit be breached, which as a result may impact the County's ability to utilize debt capacity permitted within each service-specific targets.

External Limits (Annual Repayment Limit (ARL))

In accordance with *Ontario Regulation 403/02: Debt and Financial Obligation Limits*, made under the *Municipal Act, 2001*, the County is subject to a statutory Annual Repayment Limit (ARL), which restricts annual debt servicing costs to a maximum of 25% of the County's own-source revenues. This legislated limit is intended to ensure municipalities maintain sustainable debt levels and do not overextend their financial capacity.

Internal Limits (Internal Repayment Limit (IRL))

To reinforce prudent financial stewardship, Norfolk County shall apply a more conservative internal debt limit than that imposed by legislation. The County's Internal Repayment Limit restricts total annual debt servicing costs to no more than 15% of own-source revenues. This limit is calculated using the same methodology as the ARL under *O. Reg. 403/02* and applies to the County's total debt obligations across both tax-supported and rate-supported service areas, inclusive of growth-related debts funded through Development Charges.

Internal Targets

<u>Tax-Supported Debt Repayment Target</u>

To further safeguard financial flexibility within the tax base, the County will maintain a Tax-Supported Debt Repayment Target of less than 10% of the net-levy requirement. This target applies only to debt servicing costs associated with tax-funded projects, exclusive of DC debt servicing costs for tax-related services and ensures that future budget capacity remains available for new priorities or unforeseen needs.

<u>Rate-Supported Debt Repayment Target</u>

For rate-supported services, the County will maintain a Rate-Supported Debt Repayment Target of less than 25% of the net-rate requirement. This target applies only to debt servicing costs associated with rate-funded projects, exclusive of DC debt servicing costs for rate-related services. This higher threshold reflects the significant capital requirements upcoming within the County's rate-supported infrastructure systems. While this target allows for greater flexibility, the County remains committed to responsible financial management and future updates to this policy should consider gradually reducing this threshold as system improvements are completed and additional user growth materializes.

Through the Capital Budget Process, or through any Council Report which requires an increase in rate-supported debt requirements beyond this threshold, a resolution will be required of Council requesting authorization to exceed this target.

Development Charge Debt Repayment Target

To support the responsible financing of growth-related infrastructure, Norfolk County will establish a Development Charge (DC) Debt Repayment Target requiring that annual debt servicing costs related to DC-funded debt shall not exceed 25% of annual collections of development charges.

This target ensures that DC-related borrowing is fully supported by developer contributions and avoids cross-subsidization by tax or rate-based revenues. To maintain this target, the County shall regularly monitor growth forecasts, building permit activity, and the adequacy of current DC rates to ensure collections remain sufficient to cover repayment obligations. This approach aligns with the intent of the *Development Charges Act, 1997* and reinforces the County's commitment to sustainable, growth-based capital funding practices. Where applicable, the County should prioritize the avoidance of DC debt overall, through the utilization of front-ending agreements as permitted through *Policy GP-018 Front End Financing Agreements*.

Other Debt Financing Arrangements

Internal Debt Financing

This policy, in coordination with Policy CS-23 *Reserves and Reserve Funds Policy*, governs the use of internal debt financing. Pursuant to Section 417 of the *Municipal Act, 2001*, the County may use reserves and reserve funds for purposes other than those for which they were originally established. Internal borrowing involves the temporary transfer of uncommitted balances from one reserve to another reserve or project, typically for purposes not routinely funded by the lending reserve.

While the County aims to manage reserves in a way that minimizes the need for internal borrowing, such arrangements can be advantageous. Internal financing can be used when the balance of an individual reserve is insufficient to fully fund a project, but the overall reserve portfolio is adequate. This may reduce reliance on external borrowing.

From time to time, projects authorized for external debt may instead be funded internally. In such cases, internal financing must follow the same principles and approvals required for external borrowing, including associated by-laws. Benefits of internal borrowing include flexibility in setting repayment terms, the elimination of legal and agency fees, and avoiding interest payments to third parties.

Internal debt financing is permitted for terms of up to 10 years. The lending reserve shall earn interest at a rate equal to current external borrowing rates at the time of approval, while the borrowing reserve (or project) shall be responsible for repayment of both principal and interest.

All internal financing proposals brought forward to Council must also comply with the County's *Investment Policy*. Finance staff shall prepare applicable interest rates and amortization schedules and ensure that internal borrowing arrangements adhere to all legislative and policy requirements equivalent to external financing.

Construction Financing

In most cases, Norfolk County issues long-term debt after a capital project reaches substantial completion, allowing the final debenture amount to be accurately determined. During the construction period, the County closely monitors cash flow needs and makes short- and medium-term investment decisions accordingly to ensure cash is available to pay vendors until the debt is issued. Once the long-term debt is issued, the proceeds are applied to the project, and any interim funding from reserves is reimbursed.

Alternatively, staff may recommend the use of short-term borrowing during the construction phase, commonly referred to as construction financing, to improve cash flow flexibility. While this approach can assist in managing liquidity, it also increases the overall cost of borrowing due to interest accrued during construction. If used, construction financing must comply with *Ontario Regulation 278/02 – Construction Financing*, which includes specific reporting requirements throughout the borrowing period.

Construction financing may be used for up to five years during a project's implementation. However, such arrangements should not be considered until all major construction contracts have been awarded. This ensures the financing amount reflects actual cash requirements and avoids securing funds for projects that may face significant delays. A short-term debenture by-law must be passed by Council to authorize construction financing and define its structure and associated costs.

If borrowed funds are received before construction payments are due, they may be temporarily deposited into a Reserve or Reserve Fund or invested in short-term instruments in accordance with the County's *Investment Policy*. Any interest earned on these funds must be credited to the project to reduce the final long-term borrowing requirement.

Financial Guarantees

Norfolk County recognizes that issuing financial guarantees to external parties, such as local boards, agencies, or partner organizations, may result in future financial obligations. Where the County provides a financial guarantee in support of debt issued by a third party, it should treat the full value of the guarantee as a contingent liability and include the associated servicing costs and outstanding principal in its internal debt reporting and monitoring processes.

Such guarantees, while not direct borrowings, have the potential to impact the County's fiscal position if the borrower defaults. Accordingly, the County shall incorporate the guaranteed amounts into its internal debt limitation frameworks and ensure they are disclosed as part of the County's Annual Repayment Limit analysis. This approach aligns with the principles of prudent financial management and long-term sustainability.

Responsibilities

Council:

- Norfolk County Council holds ultimate responsibility for authorizing, approving, and overseeing the issuance of debt on behalf of the Corporation of Norfolk County.

Treasurer and/or delegate has authority to:

- Recommend the project, reason, amount, terms, and/or borrowing agency for which the County should borrow.
- Update and submit documentation relating to the County's compliance with its Annual Repayment Limit, as legislatively prescribed, and periodically update Council on the status of the County's Internal Limits and Targets.
- Coordinate the negotiation of and document preparation for all debt financing.
- Coordinate annual credit rating review engagements.
- Approve amendments to this policy and its associated reports / by-laws (if applicable) for administrative or clerical reasons.
- Ensure the principles within this policy are adhered to in the normal course of the County's operations. Notwithstanding, the Treasurer has the authority to deviate from the principles in this policy if there is a reasonable expectation the recommendation will improve the County's financial strength.
- Amend the funding source of any projects included within the Approved Capital Budget or Capital Plan if it decreases the amount of debt funding required for the County.

The Mayor, along with the County Clerk, Chief Administrative Officer (CAO), and Treasurer, are authorized to sign all documentation related to debt issuances on behalf of Norfolk County. This authority may be exercised once appropriate Council authorization has been provided and all required documentation is complete.

Administration

Reporting Requirements

The actions governed by this policy shall remain in compliance with all relevant legislation, which principally includes the *Municipal Act, 2001* and its regulations, as amended. The County shall also submit its Financial Information Return annually by the prescribed deadline so that the Ministry of Municipal Affairs and Housing can confirm the County's ARL is complying with legislation.

Additionally, the Finance department shall provide clear communication to Council on the County's adherence to both internal and external debt limits/targets, through the annual budget process and other significant financial-related reports.

Communication

This policy will be made available to all Council members, staff and the public to encourage accountability and transparency. All documents will be made available in accessible formats as requested.

Evaluation

This policy will be reviewed at a minimum once every five years to ensure continued relevance, compliance, and alignment with best practices in municipal debt management.