IR14-16

November 24, 2014

To: His Worship the Mayor
and Members of City Council

Re: Annual Status Report on City Debt

RECOMMENDATION OF THE FINANCE AND ADMINISTRATION COMMITTEE - NOVEMBER 4, 2014

This report be received and filed.

FINANCE AND ADMINISTRATION COMMITTEE – NOVEMBER 4, 2014

The Committee adopted a resolution to concur in the recommendation contained in the report.

Councillors: Bryon Burnett, Bob Hawkins and Wade Murray were present during consideration of this report by the Finance and Administration Committee.

The Finance and Administration Committee, at its meeting held on November 4, 2014 considered the following report from the Administration:

RECOMMENDATION

That this report be forwarded to the November 24, 2014 meeting of City Council for information.

CONCLUSION

The City's Debt Management Policy requires the Director of Finance to annually report to Council the status of City debt in the context of its debt limit and debt ratios to help determine the affordability of its debt.

The City's current debt limit is $450 million. This amount is in effect until December 2016, at which time Council must decide to maintain or change the current debt limit by making an application to Saskatchewan Municipal Board (SMB). This report shows the method in which the City's consolidated debt is assessed to arrive at a decision of its reasonableness and affordability as of December 31, 2013. In addition, information is also presented on the City's projected debt levels.

Based on the information presented in the body of the report, the debt levels of the City are reasonable and affordable. On December 31, 2013, the City had $79.1 million in debt; the projected debt model estimates that year end debt as of 2014 and 2015 will be approximately $275 million and $363 million respectively. Although the City's debt level is expected to increase significantly, due to the Waste Water Treatment Plant and the Stadium projects, projected figures remain within the established ratio limits. Managing debt helps to improve the effectiveness of cash management, which in turn reduces costs and mitigates risk. Despite the increase in projected borrowing, the City's credit rating has not been affected as is evidenced in the recent rating by Standard and Poor's (S&P), who evaluates and maintains the City's credit rating.

The City currently uses debt to fund capital projects. Although the City's debt ratios are within the benchmark limits set within the Debt Management Policy, it is important that the City continues to be conservative with respect to its borrowing and regularly monitor debt to ensure the City maintains a sound financial position and that credit quality (rating) is protected. Remaining in good standing and taking proactive measures can help the City maintain or improve its credit rating. A well developed debt policy and effective management of debt will help maintain relationships, which will facilitate borrowing and competitive rates for the City.

BACKGROUND

The City has a Debt Management Policy administered with authority under the *Regina Administration Bylaw 2003-69, Section 25 (l) & (m)*. The policy establishes a set of parameters by which public debt obligations will be undertaken by the City of Regina. This policy reinforces the commitment by the City to manage its financial affairs in a manner that will minimize risk and ensure transparency while still meeting the capital needs of the City. A clearly articulated Debt Management Policy signals to the public, as well as credit agencies, that the City takes debt management seriously and is using a policy approach to finance capital needs.

The City has a credit rating of AA+, and the Administration is continuing to use appropriate debt finance policies and procedures to maintain this. This is a very high credit rating that signals the City is a low credit risk. Therefore, access to capital markets and favourable interest rates are relatively more available compared to organizations with lower credit ratings.

The City's Debt Management Policy requires the Director of Finance to annually report to Council the status of City debt. Therefore this report discusses the City's debt in the context of its debt limit and debt ratios to help determine the affordability of its debt.

DISCUSSION

Debt ratios are often used to assess a governmental unit's debt burden and debt trends. The affordability of debt is examined annually using the debt limit and three measures which are established in the City's Debt Management Policy: Debt Burden Percentage, Debt Capitalization Ratio, and Debt Service Ratio (See Appendix A for definition of ratios). A fourth ratio, the Financial Flexibility Ratio is also included in this report because it has been indicated to be a useful measurement tool according to Public Sector Accounting Board (PSAB) and is also used by Standard and Poor's (S&P) in their credit rating analysis (See Appendix A).

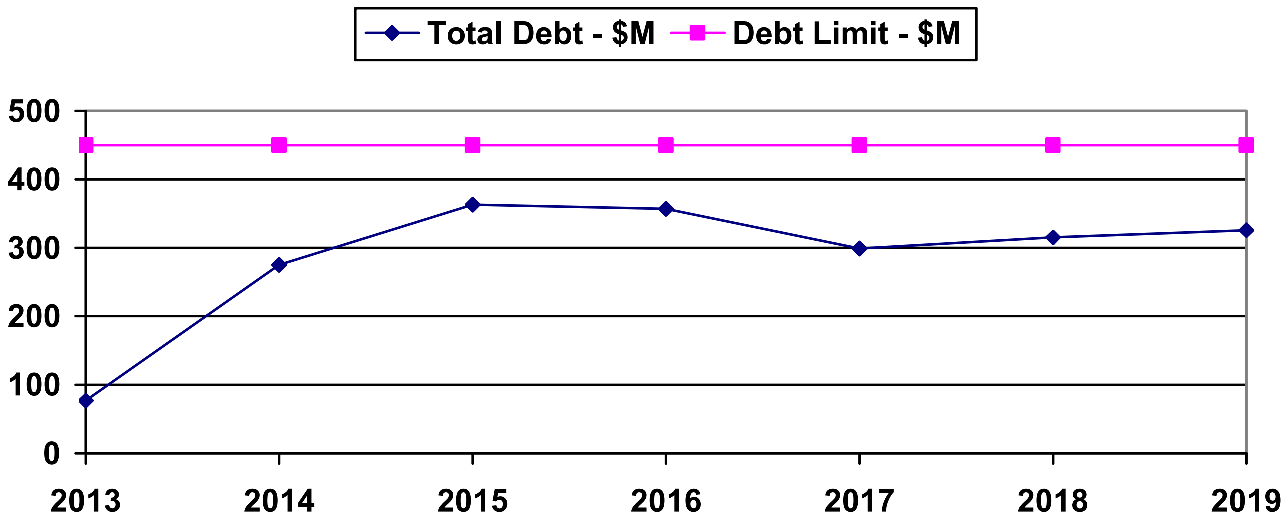
Debt, revenues and expenses are consolidated and include: City of Regina, Regina Downtown Business Improvement District, Regina Public Library, Regina Regional Opportunities Commission, Regina's Warehouse Business Improvement District and Buffalo Pound Water Administration Board.

Debt Limit and Debt Balance

The City's debt limit is $450 million with $79.1 million outstanding as of December 31, 2013. As of December 31, 2014 the outstanding debt is expected to be $275 million and $363 million by December 31, 2015. The debt limit increase was intended for the Mosaic Stadium replacement and the new waste water treatment plant. Future debt will only be issued as required, with City Council's approval.

The graph below shows the current projected total debt to 2019. It also shows that the projected debt to 2019 is not expected to surpass our debt limit of $450M, but will reach its expected peak of $363 million in 2015.

Debt Projection



Debt Burden Percentage

The debt burden percentage measures the City's cost of servicing debt, using the (annual debt interest and principal payments), as a percentage of total expenditures. The Debt Management Policy established a target rate of **less than 5%**.

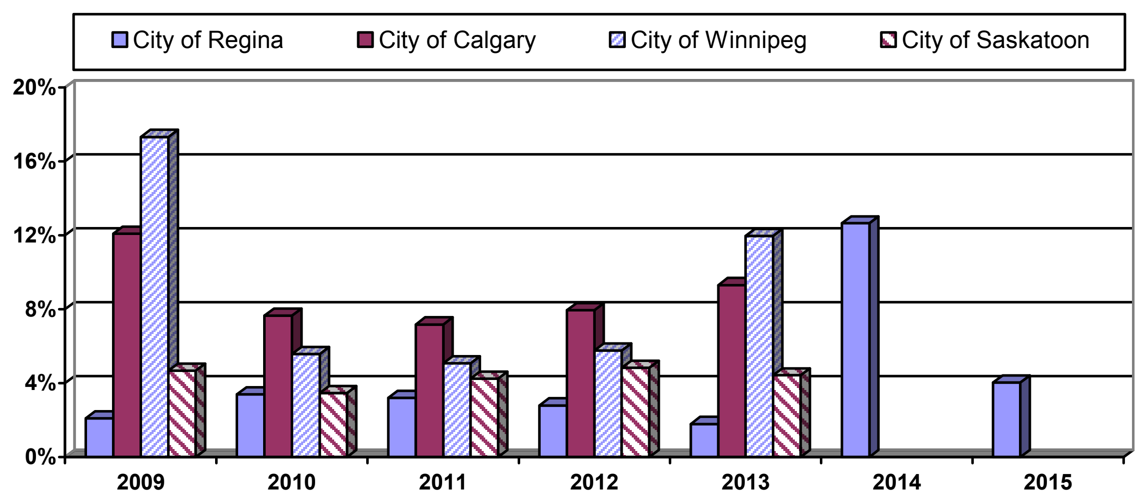
The City of Regina's debt burden percentage was 1.8% as at December 31, 2013 and has ranged from 1.8% to 3.4% within the past four years. This ratio indicates that at December 31, 2013, the City's debt payments were a low percentage of its total expenditures. This percentage will increase in 2014 in accordance with higher debt payments made in 2014.

The projected debt burden percentage will be 12.7% in 2014 and 4.0% in 2015. The spike in the ratio in 2014 is due to the $43.1 million balloon[1] debt payment made in 2014. This has resulted in the ratio being high; however, given this is an isolated incident it has not impacted our credit rating analysis done by S&P. The 2015 ratio falls within the affordability ratio.

	2009	2010	2011	2012	2013	2014	2015
Debt Burden Ratio	2.1%	3.4%	3.2%	2.8%	1.8%	12.7%	4.0%

Compared to other cities, the City of Regina debt burden percentage is lower as presented in graph 1 below.

Graph 1: City's debt burden percentage compared to other Canadian cities



1 A repayment of the outstanding principal sum made at the end of a loan period, interest only having been paid to that point.

Debt Capitalization Ratio

The Debt Capitalization Ratio measures the debt component of a company's capital structure. It describes the proportion of assets financed by debt. A higher ratio indicates a relatively weaker financial position. A target rate of **less than 5%** has been established in the Debt Management Policy.

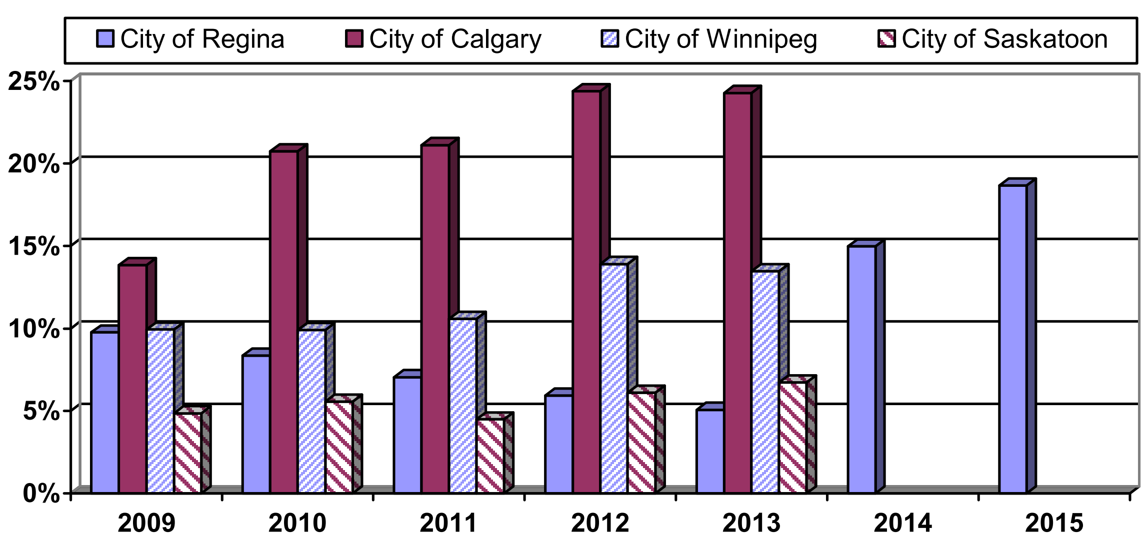
The City of Regina's debt capitalization ratio was 5.1% at December 31, 2013 and has ranged from 5.1% to 9.8% in the past five years. In 2013, the City was at the suggested 5% target, which is a significant decline over the last four years. The City's ratio is expected to increase to approximately 15% and 19% in 2014 and 2015 respectively, due to increase in debt to finance the Stadium Project and the Waste Water treatment Plant (WWTP). This ratio will be monitored as the City plans to continue borrowing in the future to fund its capital budget.

Graph 2: City's debt capitalization percentage compared to other Canadian cities

	2009	2010	2011	2012	2013	2014	2015
Debt Capitalization Ratio	9.8%	8.4%	7.0%	5.9%	5.1%	15.0%	18.7%

Historically, Regina's debt level has compared positively to other Western cities. However, our debt is beginning to increase, which is consistent with experiences in other municipalities. The City's debt ratio is low compared to Winnipeg and Calgary, but higher than Saskatoon in most years.

Graph 2: City's debt capitalization percentage compared to other Canadian cities



Debt Service Ratio

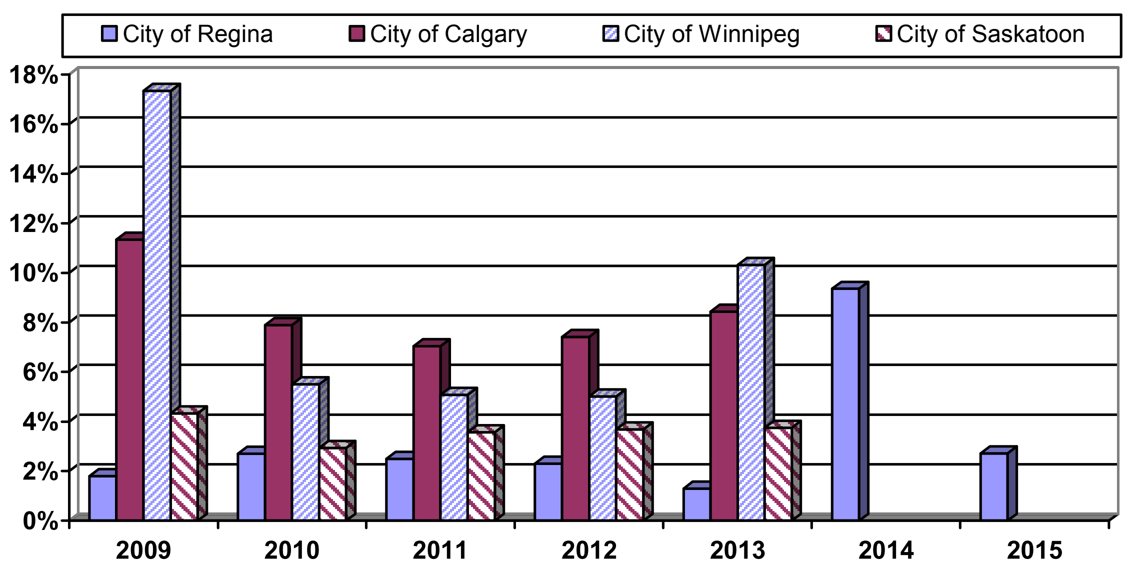
The debt service ratio measures the percentage of revenue which is required to cover debt servicing cost (interest and principal payments). This ratio is calculated by using the percentage of annual interest and principal payments on debt to total City revenues. A high debt servicing ratio indicates that there is less revenue available for providing services. It is also the prime ratio used by the credit rating agency S&P when assessing the debt burden of a municipality. The Debt Management Policy sets a target rate of **less than 5%**.

The City of Regina's debt service ratio was 1.3% at December 31, 2013, which was an improvement from the 2.3% in 2012. In 2014 the ratio is expected to increase to 9.4% which is above the 5% benchmark. This is due to the $43.1 million balloon[2] debt payment made in 2014. However, this has not affected our credit rating analysis as it is an infrequent occurrence. In 2015 the ratio is projected to fall to 2.7% which is within our benchmark. This ratio will also be monitored as the City's plans to continue borrowing in the future to finance its capital budget.

	2009	2010	2011	2012	2013	2014	2015
Debt Service Ratio	1.8%	2.7%	2.5%	2.3%	1.3%	9.4%	2.7%

Compared to other cities, the City of Regina debt service percentage is lower as presented in graph 3 below. Several factors influence this ratio such as the term of debt obligations, interest rate(s) payable and total municipal revenue levels.

Graph 3: City's debt service percentage compared to other Canadian cities



2 A repayment of the outstanding principal sum made at the end of a loan period, interest only having been paid to that point.

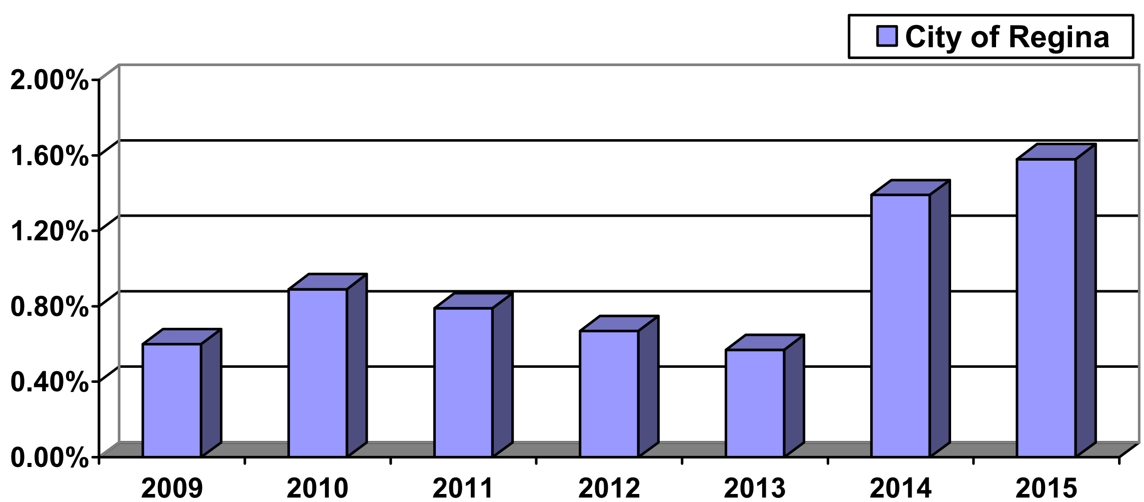
Flexibility Ratio

The financial flexibility ratio measures the percentage of the City's total revenue that is used for debt interest payments. It is a measure of degree to which an organization can change its debt and still meet its existing financial and service obligations. The more an organization uses revenues to meet the interest costs of past borrowing, the less that will be available for program spending. Flexibility is another key indicator used by S&P, with a benchmark of 0% - 5% being the most desirable.

The City's public debt charges (interest expense)-to-revenues have remained stable over the past several years at a level between 0.6% and 0.9%. This ratio decreased to 0.67% and 0.57% in 2012 and 2013 respectively, indicating an increase in flexibility since 2010. The projected future debt issuance will impact the City's financial flexibility as this ratio is expected to increase to approximately 1.4% in 2014. This increase in the ratio remains within the benchmark of 0% - 5% used by S&P.

	2009	2010	2011	2012	2013	2014	2015
Flexibility Ratio	0.60%	0.89%	0.79%	0.67%	0.57%	1.4%	1.6%

Graph 4: City of Regina flexibility percentage



RECOMMENDATION IMPLICATIONS

Financial Implications

This analysis is intended to ensure that all debt issuances and obligations are affordable and assessed using the debt affordability ratios, as per the criteria identified in the Debt Management Policy. It is important to consider all ratios and their historical trends, rather than isolating specific measures or points in time from a decision-making perspective. For 2013, the analysis of the debt ratios indicate that the City of Regina's current debt is reasonable and affordable.

In 2014 and 2015 the corporation is undertaking two projects that are partially funded with debt. While these projects will affect the debt ratios, the City's credit rating and overall financial health will not be negatively impacted as the amount of debt incurred will remain within planned levels. Most ratios that exceed the target rates in 2014 recover in 2015.

The City's unfunded pension liability has partially offset the strength of its credit rating. S&P has indicated that the pension liability, if not properly managed, can adversely impact our credit rating in the future.

Environmental Implications

The debt recently secured will be used to partially finance the Stadium Project and also for work on the Waste Water Treatment Plant. The stadium project will result in significant construction debris which will result in burden to the landfill. There will also be requirements to meet for zoning and residential criteria. The waste water treatment plant is required to meet new regulatory requirements as well as provide expanded hydraulic and process capability associated with future City growth. The environmental implications are identified in more detail under those projects.

Strategic Implications

Periodic reviews of debt levels and related policies help ensure the City's debt is effectively managed. The development of a long range financial plan for the City of Regina will include an assessment of our current Debt Management Policy and other financial policies to ensure long term financial sustainability.

Other Implications

Based upon City Council's approval to increase the limit from $350 million to $450 million on July 5, 2013, the Saskatchewan Municipal Board (SMB) requires a "renewal". The City must ensure that it brings a fresh application to the SMB in advance of December 2016 to confirm our debt limit.

Accessibility Implications

None related to this report.

COMMUNICATIONS

None related to this report.

DELEGATED AUTHORITY

As per the Debt Management Policy we recommend this report be forwarded to Council as an information item.

Respectfully submitted,

FINANCE AND ADMINISTRATION COMMITTEE

Ashley Thompson, Secretary