TRANSFORMING | **EDMONTON**

BRINGING OUR CITY VISION TO LIFE

THE WAY WE FINANCE

DEBT WHITE PAPER

Edmontonians look to their City to build, improve and repair the infrastructure essential to their day to day lives, their enjoyment and their prosperity. From the River Valley parks system to the expanding Light Rail Transit (LRT) network; from police stations and firehalls to libraries and recreation centres; from roads and bridges to sewers and utility structures, Edmontonians are investing in the infrastructure that ensures their City is one of the world's most livable urban centres.

All of this infrastructure is essential for economic growth. Both the creation and renewal of public infrastructure contributes to productivity growth which leads to economic growth. Cities keep pace when they are able to place the right infrastructure in the right places at the right time.

Edmonton's competitive challenges – at least over the past ten years – have not lay in its ability to convince investors of the City's economic potential, but rather in its ability to adapt to growth and to provide the foundation – infrastructure and services – to keep pace with the needs of a fast-growing community.

Edmonton's future success hinges on being an attractive place to live, with high quality infrastructure, great transportation systems, good access to markets, strong talent pools, and excellent services and cultural amenities. As such, the City must be able to invest in the structures and services that underline this imperative.

In order for the City to accomplish that, it must optimize its resources dedicated to the acquisition, creation and rehabilitation of infrastructure. That optimization includes the use of debt financing. To provide some context for the discussion about the use of debt, it is important to understand the extent of the City's existing public infrastructure, the funding sources available to the City for capital investment and some history of the use of debt by the City. After establishing the Edmonton context related to the use of debt, we are going to talk about what the City of Edmonton uses debt for, why it is used and how we determine what amount of debt is reasonable for the City to carry.

CONTEXT SETTING

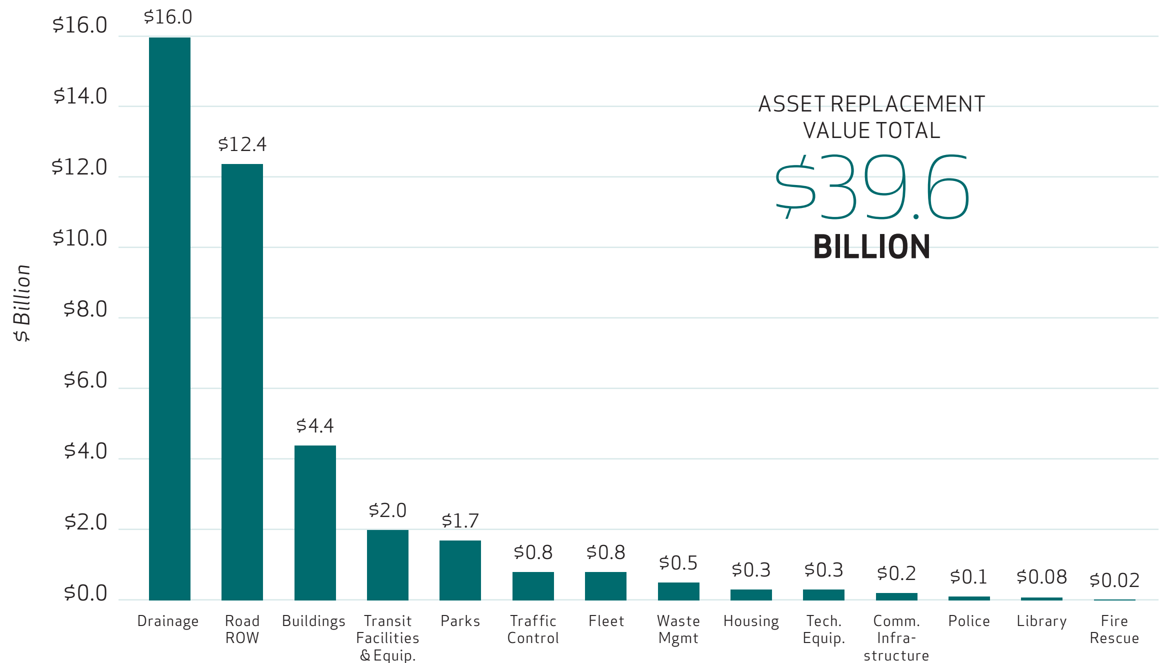
The City of Edmonton has significant capital assets that are essential for the operation and success of this large metropolis. The City is responsible for providing and maintaining capital assets and infrastructure to serve its residents and businesses. A City is sustainable only if both its capital infrastructure assets and its financial assets can be maintained over the long-term. Infrastructure is expensive to build or buy, renew or replace and the City's historic and current sources of revenue are not keeping pace with municipal infrastructure needs.

The City has a number of sources of revenue including property taxes, user fees and the sale of goods and services, franchise fees, investment income, government grants, investment earnings, fines and penalties, licensing and permits, and customer and developer contributions. Some sources of revenue, such as capital grants from other orders of government and investment earnings have been dedicated to capital infrastructure either through stipulations in the grants or as a result of City Council resolution.

THE CITY OF Edmonton

The following chart shows the replacement value of the City's infrastructure assets in 2012 dollars and provides the reader with an understanding not only of the value of the infrastructure, but the categories of assets the City owns.

FIGURE 1: ASSET REPLACEMENT VALUE



The City of Edmonton's population has increased by almost 100,000 people in the past five years with a population increase since 2012 of 60,428 or 7.4% over two years.

Over the last 10 years, the City of Edmonton implemented a program of investment in our infrastructure, unprecedented in the City's history. From 2004 to 2014, capital projects worth $9.3 billion have supported our growing city. A significant portion of this investment was to enable growth. The City has responded to the growing population and economy by building new recreation centres, libraries, police and fire stations, waste facilities, expanding LRT, renewing roadway arteries, and increasing drainage capacity.

Population growth can mean increased grant funding from other orders of government, as the Provincial and Federal governments predominantly use per-capita allocations to provide grants to municipalities. However, there is often a lag between census results and changes to grant funding. Furthermore, the overall funding does not typically change in pace with growth. When Edmonton is growing faster than the Province's or Nation's average, its allocation of the total funding increases, but that increase would not likely equal the percentage increase in population. A 10% population increase would not equate to a 10% increase in grant funding.

The City of Edmonton funds its capital program from a number of sources. Pay-as-you-go is a term used to describe paying for capital assets from current revenues. For the City, those current revenues include both property taxes and investment income. The pay-as-you-go category is broken out further to track the property tax contributions to the Neighbourhood Renewal Program. The Neighourhood Renewal Program is also partially funded through Provincial grants.

The City receives three primary capital grants from the Province: Basic Municipal Transportation Grant, Municipal Sustainability Initiative Funding and GreenTRIP. It also receives Building Canada Fund grants and Federal Gas Tax grants from the Federal Government.

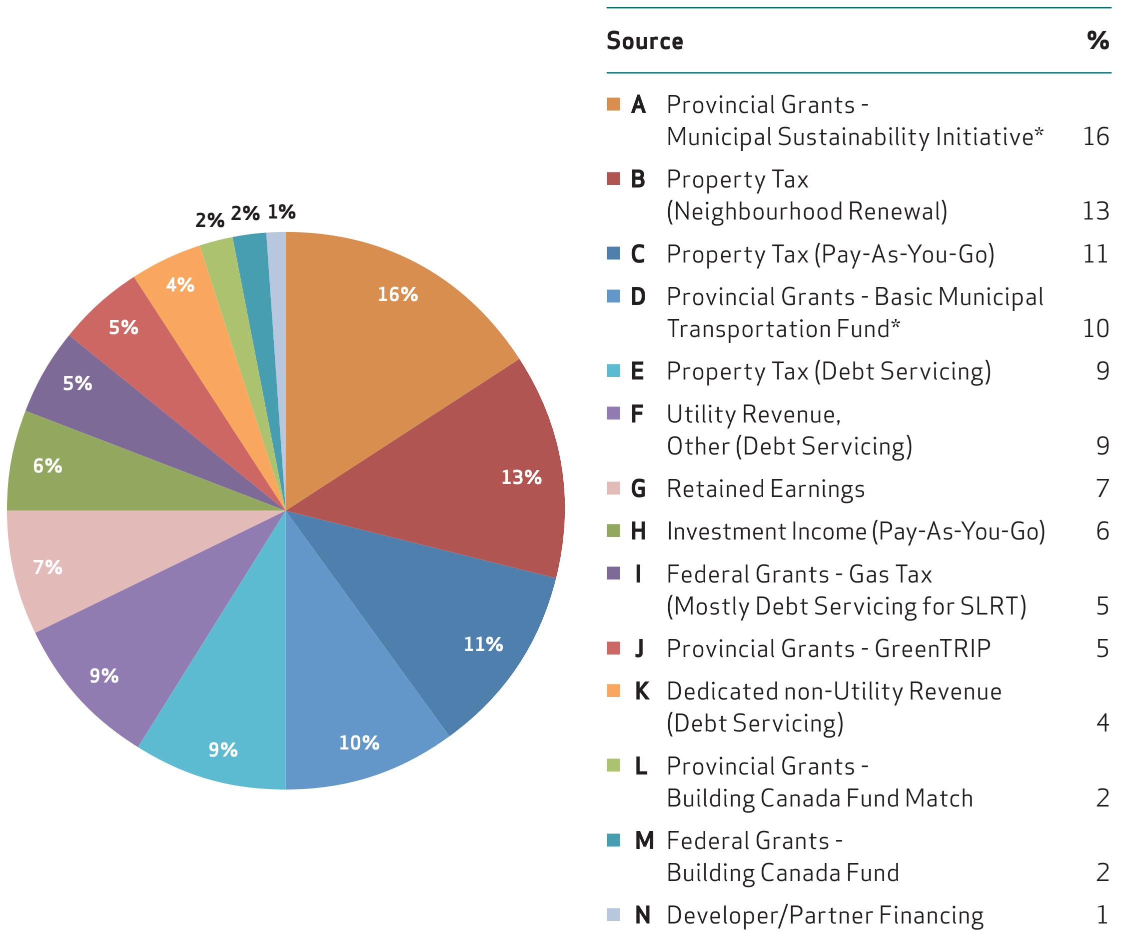
Reserves are made up of funds set aside for specific purposes. The City has a reserve for funding replacement vehicles and equipment for the City's fleet and also has a reserve for LRT. Similar to reserve funding, the City Utilities and Land Enterprise fund capital through retained earnings.

Developers and community partners contribute funding for specific infrastructure projects.

Sources of funds for debt servicing are described later in the paper.

The following chart shows the City of Edmonton's sources of funding for capital investment for the 2015 to 2018 Capital Plan.

FIGURE 2: CAPITAL FUNDING REQUIREMENTS (2015 - 2018)
TAX-SUPPORTED OPERATIONS & UTILITIES - $4.27 BILLION TOTAL



**A portion of this funding is being used to pay back fast tracking of grant funding in previous budgets*

HISTORY

City of Edmonton managed tax-supported debt in the 1970's by setting a limit on the amount of new debt that could be issued each year. New debt was generally issued for 25 year terms. Tremendous growth pressure at the end of the 1970's to support a resource boom cycle led to a relaxation of the total debt limit, resulting in a threefold increase in annual borrowing. This resulted in Edmonton's tax-supported debt being higher than most other major Canadian cities.

The recession and high interest rates of the early 1980's prompted a revised debt management policy. New tax-supported debt issues were limited to $25 million per year with a five-year repayment term. Shorter borrowing terms for utility debt (paid for with utility revenue not property taxes) were also required. The objective was to prohibit new tax-supported borrowing after 1990. Subsequent to 1990, a pay-as-you-go approach was adopted for tax-supported capital projects as an extreme reaction to the debt challenges of the 1980's.

In 2002, pay-as-you-go as a strict financial strategy was abandoned as it became impossible to provide the infrastructure required to support the growing City without huge increases in taxation to pay for costly assets on a cash basis. The City's financial debt was not growing but its infrastructure debt was becoming significant. At that time, the City estimated a gap between the value of infrastructure that could be funded with identified capital resources and the value of the infrastructure required to support the growing City to be in excess of $4 billion dollars. With a "no tax supported debt" strategy, the City was unable to address growing infrastructure issues.

Due to the decision to severely constrain the use of debt in the 1980's, and subsequent to 1990 to use debt to fund only utility infrastructure, construction of some of the types of facilities that contribute to quality of life and the economic well-being of the City did not occur. For example, neighbouring municipalities were building multi-purpose recreation centres in the late 1990's and early 2000"s. The City did not start to offer those amenities until Terwillegar Community Recreation Centre was built a decade later after the City's approach to debt financing was changed.

Tax-supported debt was reintroduced with a revised debt management fiscal policy in 2002. At that time, a $250 million borrowing guideline was established with $50 million per year allocated over five years for debt-financed projects.

As growth pressure continued to accelerate, a revised Debt Management Fiscal Policy C203C (Appendix 1) was approved in 2008 that is still in effect. The existing policy will be discussed later in the paper in the section on what amount of debt is reasonable.

WHAT THE CITY USES DEBT FOR

Unlike other orders of government, most municipalities do not borrow for operating expenditures. Federal and provincial debt often accumulates to cover on-going annual operating deficits. Operating deficits occur when revenue is not sufficient to cover on-going expenditures.

To compare this to a typical homeowner, municipalities will borrow to help pay for City infrastructure the same way a homeowner may borrow to buy their house. The provincial and federal governments also borrow money to cover shortfalls in their day to day expenditures. This would be similar to a homeowner borrowing to buy groceries or pay for their utilities. The City of Edmonton only borrows for infrastructure.

The City prepared a report in 2013 titled: Capital Projects 2004-2014, Investing in Edmonton. You can access the report at **http://www.edmonton.ca/city_government/documents/PDF/Capital_Projects_2004-2014_web.pdf**. The report provides information on the capital projects completed and underway in the 2004 to 2014 time period and will give the reader an appreciation of all of the varied infrastructure required for a city the size of Edmonton to function. The report also includes details on the projects that were financed with debt.

Some of the projects undertaken in this period that are financed at least partially with debt include:

- Terwillegar Community Recreation Centre
- Clareview Community Recreation Centre
- Meadows Community Recreation Centre
- Commonwealth Community Recreation Centre
- Whitemud/Quesnell Bridge Upgrade
- Whitemud Drive East – 34th Street Interchange
- South LRT
- North LRT
- Southeast Police Station
- Belle Rive Fire Station
- Jasper Place Library
- Kennedale Eco-Station
- Sewer Rehabiliation

Not all projects financed with debt have payments that are charged to property taxes. For example, in the list provided above, the South LRT debt is paid for predominantly with Federal Gas Tax grants and the debt for the Kennedale Eco-Station and Sewer Rehabilitation projects are paid for respectively with Waste Management and Drainage utility revenue.

WHY THE CITY USES DEBT

There are a number of reasons that the City uses debt to optimize its capital infrastructure program.

The City borrows to allow large projects to proceed without having to accumulate enough in savings to pay for all of the cost at one time.

The accumulation of savings to pay for significant infrastructure projects can mean that the taxpayers paying for the projects are not those that benefit from the projects. This concept is referred to as generational equity. Users of a capital project will likely change over its useful life and fairness would suggest that those costs should be paid by those who will use the infrastructure over time. Therefore, debt financing over a longer term can be more equitable than using funds collected and accumulated over time from current and prior residents who may not get to benefit from future improvements.

It is also difficult to accumulate funds over long periods of time as public expectation is that taxes that are paid are put to use in the short term, making it a difficult decision to tax the public and not spend the funds for longer periods of time.

In addition to these challenges, the City's large capital program does not consume resources at a consistent level. Even though the City currently engages in long-term planning for capital infrastructure, generating a 10-year capital investment agenda every three years and approving a three year capital budget (which will be moving to a four-year plan with the next capital cycle), the need for capital expenditures, particularly for new infrastructure, does not occur in consistent equal amounts annually. The City does not have smooth capital expenditure streams. A common way to describe this is that our capital expenditures are lumpy.

For new infrastructure, a good example that illustrates the lumpiness that can occur is the City's recent approval of the southeast to downtown phase of the Valley Line LRT at $1.8 Billion. This one project is equivalent to the total of almost two years of average annual capital expenditures covering numerous projects. With $1 billion in contributions to the project from Provincial and Federal grants, the City's share is $800 million. Even with a consistent and significant annual contribution of taxes and grants to fund infrastructure, it would not be possible to move forward with a project this big

without the utilization of debt. The City could not stop funding all other capital requirements in any given year in order to advance one project. Borrowing to fund LRT expansion means that the taxpayers who pay to service that debt will be the ones to enjoy the benefits of the LRT. And, LRT and other significant infrastructure projects are vital to the growth of the City.

Equally as important is maintaining the infrastructure the City already has. The City is the conscientious owner of a multi-billion dollar inventory of capital assets. This sizable responsibility demands that cost effective decisions are made in terms of when and how to maintain, repair, renew, and replace the vast network of assets which serve the diverse needs of a steadily growing metropolitan population.

Edmonton's Risk-based Infrastructure Management System (RIMS) is the key decision-making tool used to determine how much it will cost to maintain the City's infrastructure at a specific level of performance and risk and how to best optimize the allocation of funds to ensure long-term value.

At a high level RIMS includes a standardized rating system to evaluate existing infrastructure. Assets of all classes are ranked on a scale of A to F (very good to very poor); infrastructure with a D or F rating is seen as not performing to its designed function and not meeting program and service delivery needs. This provides a strategic perspective of the state and condition of our assets and is an important input to the model.

RIMS analysis determined that an annual reinvestment of $466 million (2013 dollars) is required from 2015 to 2018 to maintain our assets in a good state of repair and achieve the City's goal of reducing the number of assets in poor and very poor condition.

Of the $466 million of recommended funding in the next budget cycle, transportation related infrastructure such as roads, sidewalks and bridges, but not including buses, requires the highest renewal investment at an average of $234 million per year over the four years (2015-2018). The next largest annual renewal need over the 2015-2018 timeframe is buildings at $78 million.

However, the challenge of the lumpiness of capital expenditures applies to renewal and rehabilitation of infrastructure as well as to new infrastructure. For example, this next capital budget cycle includes a bus garage facility that is nearing the end of its service life. That means that the facility will require either a significant rehabilitation or a complete replacement of the facility. The estimated cost for total rehabilitation would consume almost the entire annual buildings capital maintenance budget for one year. Replacing the facility would cost more than two years' worth of building maintenance allocation. Borrowing to fund the replacement of the building would make sense given the significance (lumpiness) of this one project in the buildings category.

The need to borrow for capital renewal projects does not happen often, but is an option that should be available to smooth out significant peaks in required expenditure. Otherwise, funds would need to be put away annually for long periods of time in order to undertake projects with significantly higher than average capital renewal cost. In the current capital plan (2012 – 2014), an example of judicious use of debt was borrowing for the replacement of the Walterdale Bridge. The bridge had reached the end of its useful life and needed to be replaced, but in the absence of saving the money in advance, the $150 million cost would have been very difficult to accommodate within the available funding without causing a negative impact on the condition of other transportation related infrastructure.

The other challenge that arises from saving money for years to enable the cash purchase of significant infrastructure relates to the negative carrying costs that can be associated with that approach. With the impacts of inflation, it can sometimes be difficult to earn as much of a return on the investment of public funds over the life of the savings required to offset the inflationary impacts on the cost of infrastructure. In other words, the construction cost sometimes goes up faster than the interest earned on investments leaving you in a negative position. Hence the term negative carrying costs.

Debt financing also helps the City to optimize its capital funding as grant funding from other orders of government is a significant source of funding that is not available for all City infrastructure due to eligibility constraints. For example, the new Building Canada Fund will not fund recreation facilities.

Some grant funding also requires the City to provide matching funds in order to access the grant. An example of this is the Province of Alberta's GreenTRIP program. The GreenTRIP program provides funding to municipalities for public transit capital projects on a cost shared basis, with a maximum limit of two-thirds of the funding from GreenTRIP. The public transit projects the City of Edmonton has applied to have partially funded from GreenTRIP have been LRT projects costing hundreds of millions of dollars. Without the use of debt financing for the City's share of LRT projects, the City would not be able to access the GreenTRIP funding.

WHAT IS A REASONABLE LEVEL OF DEBT?

While debt is an essential financial tool for municipalities to use in moving forward their capital investment agendas, the debt must be reasonable. Not unlike a homeowner, the City must determine how much of its revenue it can reasonably afford to dedicate to making payments on debt. There are a number of factors that should be considered in determining how much debt is reasonable.

FUNDING VERSUS FINANCING

Borrowing is a method of financing capital projects. It is not a funding source itself. When debt is used to finance a project, the funds to pay for that debt need to be identified. The first consideration in determining whether or not debt is a reasonable way to finance a project is to understand what funds will be used to pay for the principal and interest payments on the debt.

The City's Debt Management Fiscal Policy C203C puts debt into two major categories based on the source of funding used to pay for the debt: tax supported and self-liquidating.

The category of tax supported debt is then broken down further based on whether the primary source of funding for making the payments on the debt is general property taxes or some other source such as grants from other orders of government, user fees, lease payments or Community Revitalization Levy revenues. For example, when City Council decided to construct the South LRT line, it borrowed over $500 million of the over $600 million project cost. The vast majority (98%) of the debt servicing for the South LRT was funded with the Federal Gas Tax Grant the City receives from the Government of Canada. The City's Debt Management Fiscal Policy C203C refers to this sub-category under tax supported debt as self-supporting tax-guaranteed debt. This sub-category of tax supported debt is included as tax supported debt for the purposes of calculating the maximum amount of money that can be dedicated to making payments on tax supported debt. For the South LRT example, even though the Federal Government has designated the Gas Tax Grant as a permanent funding stream, if for whatever reason the grant program was cancelled, the City would still need to fund the payments and might need to use property taxes to do so. Hence, it is included in the total for tax supported debt servicing.

The second category of debt is self-liquidating debt, which for the City is predominantly debt incurred on behalf of the City utilities. The primary difference is that the funding source for self-liquidating debt comes from a source other than general property taxes but it is a source that the City controls and is therefore guaranteed. In the case of utility debt, it is paid for out of utility rate revenue and City Council is the authority that approves the utilities' rates. More information on utility debt and utility fiscal policy will be provided in a separate white paper on the City utilities.

While the primary use of self-liquidating debt is the City utilities, the City also classifies debt for local improvements as self-liquidating. Local improvements are projects that are of greater benefit to an area of the City than to the whole City and as such are paid for by the property owners who are

the recipients of that benefit. If two thirds of property owners in an area petition for a project to be undertaken or the City initiates a project, then the local improvement process can begin. If no sufficient petition is filed by the property owners during the local improvement process then the local improvement bylaw can go forward and the City can tax the benefiting property owners for the cost of the improvement. So even though the debt associated with local improvements is paid for through a property tax, it is not a general tax. Therefore, local improvement debt is considered to be self-liquidating debt.

The City has also borrowed to provide a loan to Northlands for the construction of the Expo Centre that is also classified as self-liquidating debt as Northlands is contractually obligated to pay it. The City also carries debt classified as self-liquidating on behalf of homeEd, a non-profit housing provider established by the City of Edmonton.

The source of funding for making payments on debt is the most important consideration in determining what amount of debt is reasonable. The City is no different than a homeowner from that perspective. In taking out a mortgage on a house, the homeowner first has to know how they will make the mortgage payments.

AFFORDABILITY LIMITS

For homeowners, the Canada Mortgage and Housing Corporation has rules about affordability. The first rule is that your monthly housing costs shouldn't be more than 32% of your gross monthly income. Housing costs include your monthly mortgage payments (principal and interest), property taxes and heating expenses. However, that doesn't mean that every person who buys a home would be comfortable spending 32% of their income on mortgage payments, property taxes and heating. There may be other factors that impact how much the homeowner finds to be reasonable to be dedicated to those housing costs and the homeowner might set a more restrictive limit for them self. The homeowner might want to have more money to dedicate to other types of activities and therefore might not be willing to put as much of his or her monthly income into paying their mortgage.

The City of Edmonton is subject to limits both for total debt and debt servicing (the principal and interest payments on debt) by the *Municipal Government Act*, RSA 2000, c M-26 (*MGA*), which is the principal legislation that governs municipalities in Alberta. Section 271 allows the Minister of Municipal Affairs to make regulations respecting how a debt limit for a municipality is determined. The *MGA* Debt Limit Regulation AR 255/2000 specifies that the debt limit for the City of Edmonton in respect of the City's total debt is 2 times the revenue of the municipality, and in respect of the City's debt service, is .35 times the revenue of the municipality. The revenue for purposes of this calculation is the consolidated revenue of the City less capital government transfers and developer contributed tangible capital assets and excludes revenue from EPCOR. These proportional debt and debt servicing limits mean that as revenues grow, the amount of debt and debt servicing can increase.

Despite these regulated debt limits, it is important for the City not to just borrow up to those limits, particularly with respect to debt servicing, without gauging what is appropriate or optimal for Edmonton. Just like the homeowner might not want to spend as much on mortgage payments as the bank is willing to let them, the City has to consider what other uses it has for funds that could be used to pay for debt. The potential allocation of 35% of Edmonton's eligible revenue to debt servicing would be significant for an organization that has large operating expenditures associated with the day to day programs and services that Edmontonian's expect. It is important to understand the relationship between funding capital assets and the associated operating impacts of those assets and to recognize that there are affordability limits to property taxes that are a significant source for debt servicing.

In developing the existing City of Edmonton Debt Management Fiscal Policy C203C, the City took a more conservative approach than what is mandated by the *MGA* by constraining the limit for total debt servicing for both tax supported debt, including self-supported tax-guaranteed debt, and self-liquidating debt to 22% of eligible revenues. The policy further constrains tax supported debt servicing, which includes self-supported tax guaranteed debt to 15% of eligible revenues. These limits were established when the policy was developed in 2008 based on the following rationale.

The City borrows almost exclusively through the Alberta Capital Finance Authority (ACFA), which provides capital financing to Alberta's Municipalities at very competitive rates as they are secured with the Province's triple A credit rating. The ACFA has its own credit policy that mandates a credit review process for municipalities with no credit rating or with a credit rating less than "A" that are within 25% of the limit established under the *MGA*. That is not to say that the ACFA will not lend to municipalities that are over 75% of the *MGA* limits, but rather that those municipalities are subject to greater credit scrutiny prior to loans being granted. This means that for debt servicing, the ACFA would subject most municipalities to greater scrutiny if their debt servicing was greater than 26% of eligible revenues.

Given that the City's approach to debt just prior to the policy being developed was extremely risk adverse and limited the total debt to $250 million dollars at $50 million per year over 2002 to 2007, the City acknowledged the need to provide greater flexibility for the use of debt while at the same time maintaining a fiscally conservative approach to debt. When the current policy was drafted in 2008, it achieved this by setting the debt servicing limit at 85% of the trigger percentage set by ACFA for the need for a municipality to undergo a credit review. This was despite the fact that the City would not have to be subjected to the ACFA's credit review process even if it was within 25% of the *MGA* limits as the City has a credit rating that is greater than "A" having been rated by Standard and Poors at "AA+". Administration recommended taking a more conservative approach than even that which would trigger a credit review by the ACFA for municipalities subject to such a review. The recommendation to set the percentage for total debt servicing at a conservative 85% of the 26% of eligible revenues for debt servicing ACFA credit review trigger resulted in the 22% limit for total debt servicing in the City's current policy. This risk-adverse approach was taken to ensure that debt remained affordable and sustainable.

The split between tax supported debt servicing and self-liquidating debt servicing was predicated on projections at that time about the known capital investments that were required for the City utilities and local improvements and providing ample room for self-liquidating debt servicing. This resulted in the policy constraints on debt servicing of 15% of eligible revenues for tax supported debt and basically ensured that the limit of 22% of eligible revenues for total debt servicing would not be reached.

Under the Debt Management Fiscal Policy C203C, eligible revenues for the purpose of calculating the limits for total debt servicing are the annual revenues reported in the last audited financial statements prior to the time of calculation. So the debt servicing limit calculated during 2014 would be based on the revenues reported in the December 31, 2013 financial statements. The revenues include property taxes, user fees (including revenue from the City's utilities), program revenue, and developer and partner contributions; but do not include Provincial and Federal capital grants or the value of contributed tangible capital assets. Contributed tangible capital assets are infrastructure that is constructed by others, usually developers, that become City property. For example, in a new neighbourhood, a developer will build roads and sewers, but those assets are then turned over to the City and become City property. The value of those assets is not considered as revenue to the City for the purpose of calculating debt and debt servicing limits.

Eligible revenues for the purpose of calculating the limits for tax supported debt servicing are the same as for total debt servicing less the revenues generated by the City's utility and enterprise operations and certain other revenues from external parties. A review of the City's Debt Management Fiscal Policy C203C should consider whether all of the revenues currently included as eligible revenue for the purpose of calculating the debt servicing limits should be included. For example, all property taxes are included as eligible revenue even though a portion of property taxes is already utilized to fund capital assets. For example, the Neighbourhood Renewal Program is funded by dedicated property taxes that amounted to $87 million in 2014. This is funding that is already dedicated to capital on a pay-as-you-go basis yet is considered in the revenue to determine the limits for debt servicing, which is also for capital.

INTEREST RATES

One of the factors often raised as a consideration in whether or not to borrow is the level of interest rates. And interest rates should be considered. However, interest rates being low should not be the only consideration in determining whether or not to borrow. As stated early, how much is a reasonable amount to spend on payments on the debt should still be the prime consideration. Once an amount that is reasonable to be spent on making payments on debt is determined, whether or not interest rates are considered to be low or high doesn't change that amount, but it does affect the amount of debt that could be incurred. In times of low interest rates, debt is leveraged to provide greater value than when interest rates are high. For example, for a homeowner that can afford to pay $2,000 a month for a mortgage payment, if the interest rate on the mortgage is 3%, the homeowner could borrow approximately $360,000 over twenty years. If the interest rate was 6%, the homeowner could borrow approximately $280,000 over twenty years. This is assuming that the interest rate stays the same for the entire twenty years of the mortgage, which for home mortgages is not likely. For Alberta municipalities, interest rates can be locked in for the entire term of the borrowing, whether that is 5 years or 35 years.

The impact of higher interest rates is the same for the City as for a homeowner. The higher the interest rates, the less debt the City can afford to take on as the debt servicing becomes more expensive. Careful analysis that considers the time value of money and investment earning potential versus interest costs needs to be undertaken when interest rates climb.

DEBT AND DEBT SERVICING

The table on the next page shows the City's long term debt from 2004 until 2013 split between tax supported, self-supporting tax-guaranteed and self-liquidating. It also includes the debt limits for each year calculated based on two times the total consolidated revenues less capital government transfers and developer contributed tangible capital assets.

The table also shows the debt servicing for the same time period 2004 to 2013, again split between tax supported, self-supporting tax-guaranteed and self-liquidating. The debt servicing limits for the *MGA* at 35% of eligible revenue and for the Debt Management Fiscal Policy (DMFP) C203C at 22% are included. The debt and debt servicing does not include debt and debt servicing related to EPCOR. The sinking fund captioned in the table relates to EPCOR debt.

THE CITY OF Edmonton

FIGURE 3: DEBT AND DEBT SERVICING 2004-2013 ($000'S)

LONG-TERM DEBT (NET OF EPCOR & SINKING FUND)

	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004
Tax-Supported										
Self-Supporting										
Tax-Guaranteed	$ 563,818	$ 578,735	$ 569,237	$ 574,331	$ 579,731	$ 384,656	$ 190,484	$ 37,611	$ 11,000	$ -
Tax-Supported	1,048,793	886,376	696,633	615,427	374,308	163,425	139,059	109,890	92,784	59,217
	1,612,611	1,465,111	1,265,870	1,189,758	954,039	548,081	329,543	147,501	103,784	59,217
Self-liquidating	$ 813,576	$ 767,810	$ 707,949	$ 650,475	$ 554,680	$ 495,357	$ 431,842	$ 399,159	$ 369,247	$ 361,119
Total (net)	$ 2,426,187	$ 2,232,921	$ 1,973,819	$ 1,840,233	$ 1,508,719	$ 1,043,438	$ 761,385	$ 546,660	$ 473,031	$ 420,336
Total Debt Limit	$ 4,620,040	$ 4,180,392	$ 4,079,024	$ 3,679,534	$ 3,243,406	$ 3,003,628	$ 3,157,284	$ 2,842,856	$ 2,721,190	$ 2,362,738
% Used	52.5%	53.4%	48.4%	50.0%	46.5%	34.7%	24.1%	19.2%	17.4%	17.8%

DEBT SERVICING (NET OF EPCOR & SINKING FUND) - CALCULATED AS REQUIRED BY THE *MGA*

The debt servicing reported under a specific year is actually the total of principal and interest that the municipality will pay in the 12 months following the year end. A pro-rated amount, as per *MGA* regulation, to represent an obligation for short-term borrowing where no principal payments are required until the end of the term is included in years where no payments were made.

	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004
Tax-Supported										
Self-Supporting										
Tax-Guaranteed	$ 53,050	$ 52,331	$ 49,325	$ 48,073	$ 47,327	$ 31,101	$ 15,201	$ 3,099	$ 1,037	$ -
Tax-Supported	122,051	96,080	69,451	60,368	30,624	18,132	15,341	11,305	9,230	5,715
	175,101	148,411	118,776	108,441	77,951	49,233	30,542	14,404	10,267	$ 5,715
Self-liquidating	$ 80,677	$ 75,105	$ 69,328	$ 64,184	$ 60,720	$ 53,891	$ 47,053	$ 45,876	$ 45,518	$ 49,321
Total (net)	$ 255,778	$ 223,516	$ 188,104	$ 172,625	$ 138,671	$ 103,124	$ 77,595	$ 60,280	$ 55,785	$ 55,036
Debt Servicing Limit *MGA* (35%)	$ 808,507	$ 731,569	$ 713,829	$ 643,918	$ 567,596	$ 525,635	$ 552,525	$ 497,500	$ 476,208	$ 413,479
% Used	31.6%	30.6%	26.4%	26.8%	24.4%	19.6%	14.0%	12.1%	11.7%	13.3%

DEBT SERVICING (NET OF EPCOR & SINKING FUND) - LIMIT AS PER CITY OF EDMONTON DEBT MANAGEMENT FISCAL POLICY C203C

The debt servicing reported under a specific year is the total of principal and interest that the municipality paid in that year including actual interest and principal payments for short term debt.

	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004
Tax-Supported										
Self-Supporting										
Tax-Guaranteed	$ 51,537	$ 49,870	$ 45,571	$ 47,679	$ 38,055	$ 18,553	$ 6,598	$ 1,249	$ 243	$ -
Tax-Supported	67,862	57,040	53,028	36,640	22,327	16,358	12,853	9,785	7,171	12,203
	119,399	106,910	98,599	84,319	60,382	34,911	19,451	11,034	7,414	12,203
Self-liquidating	$ 75,598	$ 69,607	$ 64,995	$ 59,730	$ 49,069	$ 47,402	$ 45,345	$ 45,007	$ 49,616	$ 53,672
Total (net)	$ 194,997	$ 176,517	$ 163,594	$ 144,049	$ 109,451	$ 82,313	$ 64,796	$ 56,041	$ 57,030	$ 65,875
Debt Servicing Limit DMFP (22%)	$ 508,204	$ 459,843	$ 448,693	$ 404,749	$ 356,775	$ 330,399	$ 347,301	$ 312,714	$ 299,331	$ 259,901
% Used	38.4%	38.4%	36.5%	35.6%	30.7%	24.9%	18.7%	17.9%	19.1%	25.3%

While the City's use of debt has increased significantly since moving away from the "no tax-supported debt" approach mandated prior to 2002 it has remained reasonable and sustainable. The gradual build-up of debt has allowed major infrastructure projects such as South and North LRT, four multi-purpose recreation centres, Quesnell Bridge enhancements, Walterdale Bridge replacement, police and fire station additions and new libraries to be constructed. The interest rates during this period have been reasonable with the rates for the last six years being historically low.

At December 31, 2013 the City had utilized 52.5% of its total allowable debt and 31.6% of its total allowable debt servicing as regulated under the *MGA*. It had utilized 38.4% of its total allowable debt servicing under the more conservative City of Edmonton Debt Management Fiscal Policy C203C.

The table on the next page provides the actual debt as at December 31, 2013 as well as projected debt for December 31, 2014 through to 2018. The projected debt includes financing for ongoing capital projects approved by Council. Additional borrowing of $1.3 billion including $268 million for Rogers Place (downtown arena) and $813 million for the Valley Line LRT phase 1 is forecast for 2014 and subsequent years.

Debt servicing under the categories and limits allowed under the City's Debt Management Fiscal Policy C203C are also included in the table. Debt limits and debt servicing limits for 2015 and beyond assume general annual revenue increases of 5%. For context the average annual revenue increase over the past 5 years has been 9%. Where projections exist for specific revenue sources, such as the Capital City Downtown Community Revitalization Levy, those projections have been used.

FIGURE 4: ACTUAL AND PROJECTED DEBT AND DEBT SERVICING 2013-2018 ($000'S)

Debt (net of EPCOR & Sinking fund)	**Actual Debt Dec 2013**	**Projected Debt Dec 2014**	**Projected Debt Dec 2015**	**Projected Debt Dec 2016**	**Projected Debt Dec 2017**	**Projected Debt Dec 2018**
Tax-Supported Debt						
Long-term	$ 928,793	$ 1,048,514	$ 1,191,420	$ 1,305,207	$ 1,444,660	$ 1,548,426
Short-term	120,000	120,000	60,000	60,000	-	-
Self-Supporting Tax-Guaranteed	563,818	880,544	990,626	1,034,088	1,001,927	963,944
Total Tax-Supported Debt	$ 1,612,611	$ 2,049,058	$ 2,242,046	$ 2,399,295	$ 2,446,587	$ 2,512,370
Self-Liquidating Debt	813,576	872,130	998,689	1,087,567	1,160,280	1,200,482
Total Debt	$ 2,426,187	$ 2,921,188	$ 3,240,735	$ 3,486,862	$ 3,606,867	$ 3,712,852
Debt Limit (As per *MGA*)	$ 4,620,040	$ 4,620,040	$ 4,851,042	$ 5,094,151	$ 5,610,650	$ 5,695,738
% Used	52.5%	63.2%	66.8%	68.4%	64.3%	65.2%
% Available	47.5%	36.8%	33.2%	31.6%	35.7%	34.8%

Debt Servicing Limits as per City of Edmonton Debt Management Fiscal Policy C203C	**Actual Debt Servicing 2013**	**Projected Debt Servicing 2014**	**Projected Debt Servicing 2015**	**Projected Debt Servicing 2016**	**Projected Debt Servicing 2017**	**Projected Debt Servicing 2018**
DMFP Total Debt Servicing (22%)						
Total Debt Servicing	$ 194,997	$ 223,594	$ 310,818	$ 277,665	$ 354,432	$ 303,441
Debt Service Limit (22% of eligible revenues)	$ 508,204	$ 508,204	$ 533,615	$ 560,357	$ 617,172	$ 626,531
% Used	38.4%	44.0%	58.2%	49.6%	57.4%	48.4%
% Available	61.6%	56.0%	41.8%	50.4%	42.6%	51.6%
% of eligible revenue (max 22%)	8.4%	9.7%	12.8%	10.9%	12.6%	10.7%
DMFP Tax-supported Debt Servicing (15%)						
Tax-Supported-Long Term	$ 65,023	$ 77,702	$ 90,026	$ 98,334	$ 104,901	$ 109,489
Self-Supported Tax-Guaranteed	51,537	62,361	71,208	81,906	85,136	85,756
Short Term	2,839	2,839	62,839	1,097	61,097	-
Total Debt Servicing	$ 119,399	$ 142,902	$ 224,073	$ 181,337	$ 251,134	$ 195,245
Debt Service Limit (15% of eligible revenues)	$ 279,113	$ 279,113	$ 293,069	$ 307,764	$ 323,501	$ 341,916
% Used	42.8%	51.2%	76.5%	58.9%	77.6%	57.1%
% Available	57.2%	48.8%	23.5%	41.1%	22.4%	42.9%
% of eligible revenue (maximum 15%)						
Tax-Supported - Long Term	3.5%	4.2%	4.6%	4.8%	4.9%	4.8%
Self-Supported Tax-Guaranteed	2.8%	3.4%	3.6%	4.0%	3.9%	3.8%
Short Term	0.2%	0.2%	3.2%	0.1%	2.8%	0.0%
Total Debt Servicing	6.4%	7.7%	11.5%	8.8%	11.6%	8.6%

Tax-supported debt is limited under the Debt Management Fiscal Policy (DMFP) C203C to 15% of eligible revenues. Debt servicing can fluctuate as older debt is paid off and new debt is taken on. As figure 4 illustrates, the City's projected tax-supported debt servicing hits a high in 2015 and 2017 with up to 76.5% and 77.6% of the DMFP tax-supported debt limit utilized. These spikes result from the repayment of short term debt. The City has taken out two borrowings of $60 million in short term debt for terms of five years with only the interest on the debt payable annually. The principal is paid all at once at the end of the five years. This occurs in both 2015 and 2017, which causes the significant increase in debt servicing in those two years. The short term debt is reported under tax-supported debt even though it is to be repaid with Provincial grant funding from the Municipal Sustainability Initiative and the Basic Transportation Grant.

Actual tax-supported debt servicing for 2013 amounted to 6.4% of eligible City revenues. Of that, 2.8% was in the category of self-supported tax-guaranteed (funded from a specific source not general property taxes) and 0.2% was interest on short term debt; leaving tax-supported debt servicing from more general property taxes and revenues at just 3.5% of eligible revenue. The projections for 2018 show tax-supported debt servicing at 8.6% of eligible revenues. Of that, 3.8% is in the category of self-supported tax-guaranteed, and there is no short term debt; leaving tax-supported debt servicing from more general property taxes and revenues at 4.8% of eligible revenues.

As with the description of tax supported debt, total debt servicing (tax supported, self-supported tax-guaranteed and self-liquidating) also peaks in 2015 and 2017 due to repayment of the principal on short term debt. The peak in 2015, even with the repayment of short term debt principal, is at 12.8% of eligible revenues, significantly under the 22% limit in the DMFP and a little more than a third of the provincial limit of 35%.

To go back to our homeowner example, the average household income in Edmonton is $91,860 (2011 Statistics Canada). If a homeowner with the average household income were to limit mortgage payments on their house to 5% of that household income (as is projected for the City for 2018 tax supported debt without self-supported tax guaranteed debt), that would amount to approximately $4,600 a year and would fund a 20-year mortgage at 3% interest of approximately $69,000. So in other words, it might be affordable, but it wouldn't be sufficient to purchase a house in Edmonton.

The projected debt and projected debt servicing in figure 4 does not include projects that Administration will be recommending for tax supported debt financing in the 2015 to 2018 capital budget that have not yet been approved by City Council. The impact of those projects, even with no adjustment to projected revenue, would result in a projected increase in tax supported debt servicing by 2018 to 9.3% of eligible revenues versus the 8.6% identified in the table. The projected total debt servicing for 2018 would increase to 11.3% from the 10.7% identified in the table.

CONCLUSION

The City of Edmonton utilizes debt financing as part of a well-balanced approach to optimizing funding sources available for the acquisition, creation and rehabilitation of infrastructure.

The City of Edmonton has significant capital assets that are essential for its operation and for the quality of life Edmontonian's enjoy. The City is responsible for providing and maintaining capital assets and infrastructure to serve its residents and businesses. A City is sustainable only if both its capital infrastructure assets and its financial assets can be maintained over the long-term.

All of this infrastructure is essential for economic growth. Both the creation and renewal of public infrastructure contributes to productivity growth which leads to economic growth. Cities keep pace when they are able to place the right infrastructure in the right places at the right time. In order for the City to accomplish that, it must optimize its resources dedicated to the creation and rehabilitation of infrastructure. That optimization includes the use of debt financing.

The City of Edmonton takes a conservative approach to the use of debt staying well-under the provincially legislated limits for debt and debt servicing through implementation of its own Debt Management Fiscal Policy C203C. It would be timely to review this policy, which was approved in 2008.

APPENDIX 1

CITY POLICY

REFERENCE:	POLICY NUMBER: C203C
City Council 2008 07 23 City Council 2002 09 17 City Council 1991 12 03 City Council Minutes 1986 12 09 City Council Minutes 1984 02 28 pg. 558, 559 City Council Minutes 1982 03 09 pg. 44 City Council Minutes 1980 08 12 pg. 1689-91 Municipal Government Act, R.S.A 2000, C.26 (as amended) Debt Limit, A.R. 255/2000 City Policy C304B – Utility Fiscal Policy (as amended) City Policy C200B – Financing of Local Improvements (as amended)	**ADOPTED BY:** City Council 2008 07 23 **SUPERCEDES:** C203B
PREPARED BY: Corporate Services	**DATE:** 2008 07 23
TITLE: **Debt Management Fiscal Policy**	

Policy Statement:

1. Debt is an ongoing component of the City's capital financing structure and is integrated into the City's long-term plans and strategies.
2. Debt must be Affordable and Sustainable. The City must maintain Flexibility to issue Debt in response to emerging financing needs.
3. Debt must be structured in a way that is fair and equitable to those who pay and benefit from the underlying assets over time.
4. Debt decisions must contribute to a sustainable and vibrant City by balancing quality of life and financial considerations.
5. The issuance of new Debt must be approved by City Council.
6. Debt must be managed, monitored and reported upon.

The purpose of this policy is to:

Establish financial guidelines and appropriate controls for the issuance and use of new Debt and to ensure a favourable financial position while supporting the City's ability to meet current and future infrastructure challenges.

This policy is subject to any specific provisions of the Municipal Government Act or other relevant legislation or Union Agreement.

CITY PROCEDURE

		POLICY NUMBER:	C203C
AUTHORITY:	City Manager	EFFECTIVE DATE:	2009 07 09
TITLE:	**Debt Management Fiscal Policy**		
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1. DEFINITIONS

1.1 **Affordability** – means ability to pay for Debt Servicing costs and life cycle expenditures for the underlying asset. The overall measure of Affordable Debt is the burden of Debt Servicing costs and life cycle expenditures relative to City revenues.

1.2 **Capital Expenditures** – means expenditures incurred to acquire, develop, renovate or replace capital assets as defined by Public Sector Accounting Board section 3150.

1.3 **City Revenues** - means annual revenues as published in the last audited financial statements of the City prior to the time of calculation, to include revenues from taxes, Utilities, user fees, departmental and corporate programs, developer and customer contributions, and Boards and Authorities as calculated under the Debt Limit Regulation A.R. 255/2000, as amended.

1.4 **Debt –** means borrowing as defined under MGA section 241(a). In the case of the City, this is usually in the form of a debenture varying in Debt Terms. Other forms of debt include but are not limited to, leases of capital property as defined under MGA section 241, other long-term financial commitments, Public Private Partnerships (PPP), Community Revitalization Levy financing, loans and loan guarantees issued under section 264 & 265 of MGA.

1.5 **Debt Servicing** – means annual required Debt repayments including interest and principal.

1.6 **Debt Term** – The period of time during which Debt payments are made. At the end of the Debt Term, the Debt must be paid in full.

1.7 **Flexibility –** is the ability of the City to issue new debt in response to emerging financing needs.

1.8 **Internal Municipal Debt Limits** - means the City's maximum Debt Service costs allowed as set out in section 2.04.

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1.9 **Interim financing –** means borrowing made for the purpose of temporarily financing a capital project as defined under MGA section 259.

1.10 **Long-Term Debt** – Debt with terms greater than five years as defined under MGA section 258.

1.11 **Self-Supporting Tax Guaranteed Debt –** Debt issued to finance Capital Expenditures by non-utility operations that ordinarily generate sufficient cash to fund all obligations or have a dedicated source of revenues. Any funding shortfall to repay the Debt will be funded through Tax Levy Revenues.

1.12 **Self-Liquidating Debt –** Debt assumed to fund Capital Expenditures by activities or programs which are self-funded, including but not limited to Utilities and local improvements.

1.13 **Short-Term Debt –** Debt with terms of five years or less as defined under MGA section 257. For the purpose of this Procedure, Short-Term Debt excludes a line of credit and the issue and sale of commercial paper in the form of short-term promissory notes maturing not more than one year from the date of issue for the purpose of financing operating expenditures.

1.14 **Sustainable –** means meeting present needs without compromising the ability to meet future needs.

1.15 **Tax Levy Revenues –** means revenues generated to pay for Tax-Supported Operations. This includes revenues such as property and business taxes, non-utility user fees, fines, permits and investment income.

1.16 **Tax-Supported Debt -** means Debt issued for Capital Expenditures related to Tax-Supported Operations. This Debt is repaid using Tax Levy Revenues.

1.17 **Tax-Supported Operations -** represent civic programs that are funded through Tax Levy Revenues, such as roads, transit, and parks.

1.18 **Utilities -** are self-funded operations providing a service to its customers, including a return on investment, at rates regulated by City Council. An example would be the Sanitary Utility.

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2. FINANCIAL GUIDELINES

2.01 Use of Debt

2.01.1 The City will not issue Long-Term Debt or Short-Term Debt obligations to finance current operating expenditures.

2.01.2 When making a decision about the use of debt, alternative capital financing sources should be considered.

2.01.3 Long-Term Debt will be considered for Capital Expenditures for:
- **a)** large projects with long-term benefits;
- **b)** projects with benefits to the community at large (for tax-supported debt);
- **c)** growth related projects;
- **d)** emerging needs to support corporate priorities and approved strategic plans; and
- **e)** major rehabilitation of existing assets as a short-term strategy to eliminate a significant backlog.

2.01.4 Short-Term Debt can be considered for interim Financing for Capital Expenditures.

2.02 Debt Approval

2.02.1 A multi-year Debt guideline and corresponding Debt Service funding strategies, consistent with the capital planning and budget cycle, will be developed. The guideline will be segregated by debt categories as identified under section 2.05.1.

2.02.2 Capital projects for Debt financing will proceed through the budget process.

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2.02.3 New debt issues will:
- **a)** be Affordable, Sustainable and maintain the City's financial flexibility;
- **b)** identify sources of funding for Debt repayment; and
- **c)** align with the City's capital plans and strategies and other financial and non-financial considerations to support a positive image of the City.

2.03 Debt Planning & Management

2.03.1 All issuance of Debt requires an authorized bylaw.

2.03.2 Internal processes and systems will be developed and maintained to ensure sound Debt management.

2.04 Debt Limits

2.04.1 The City has established internal Municipal Debt Limits based on Debt Servicing costs at:
- **a)** 22% of City revenues for total Debt; and
- **b)** 15% of Tax Levy Revenue for Tax-Supported debt.

2.05 Debt Categories

2.05.1 To support Debt planning, management and reporting, Debt is categorized into three groups based on the funding source for Debt Service as follows:
- **a)** Tax-Supported Debt;
- **b)** Self-Supporting Tax-Guaranteed Debt; or
- **c)** Self-Liquidating Debt.

2.05.2 Self-Supporting Tax-Guaranteed Debt is considered Tax-Supported Debt for the purpose of sections 2.02 and 2.04 of this Procedure.

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2.06 Debt Amortization Term

2.06.1 Debt Term shall not exceed the probable lifetime of the underlying asset. It is preferred for the Debt Term to be less than the probable lifetime of the asset, if it is Affordable.

2.06.2 The following elements should be considered when establishing the Debt Term: cost minimization, availability of Debt Servicing funding, fair distribution of costs between periods, capital life cycle implications, if it is Sustainable, and the City's financial Flexibility.

2.07 Debt Structure

2.07.1 Alternative Debt repayment structures can be utilized to issue Debt. Examples are payment arrangements such as, level Debt Service, level principal, bullet, fixed and variable rates.

2.07.2 Alternative borrowing techniques and strategies shall be considered if benefits can be demonstrated. Examples are lease financing and interest rate swaps.

2.07.3 Risk mitigation strategies will be developed when these alternative financing techniques are considered.

2.08 Debt Repayment Funding

2.08.1 New Debt Service costs will be funded by long-term sustainable revenue.

2.08.2 New Debt Service costs for Utilities, local improvements and community revitalization levy financing will be funded through corresponding revenues.

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2.08.3 As Debt retires, released Debt Service funding will be used to fund new debt Service costs, and/or to directly fund Capital Expenditures.

2.09 Debt Prepayment or Refinancing

2.09.1 Procedures will be developed to review and consider cost saving opportunities through prepayment or refinancing of existing debt.

2.10 Reporting

2.10.1 The City's utilization of Debt will be reported through regular performance reporting.

2.10.2 For benchmarking, the City's debt will be monitored and reported in the Annual Report, at a minimum, against the limits and guidelines identified in section 2.04.

This policy is subject to any specific provisions of the Municipal Government Act or other relevant legislation or Union Agreement.