TO:	**GENERAL COMMITTEE**
SUBJECT:	**LONG RANGE FINANCIAL PLAN AND FINANCIAL POLICY FRAMEWORK UPDATE**
PREPARED BY AND KEY CONTACT:	**C. Millar, Deputy Treasurer, Ext 4436**
SUBMITTED BY:	**D. McKinnon, Director of Finance, Ext 5130**
GENERAL MANAGER APPROVAL:	**E. Archer, General Manager of Corporate Services**
CHIEF ADMINISTRATIVE OFFICER APPROVAL:	**JON M. BABULIC, CHIEF ADMINISTRATIVE OFFICER**

RECOMMENDED MOTION

1. That the following strategies be implemented, starting with the 2012 Business Plan, to strengthen the City's financial condition:

   a) Increase annual contributions to the Tax Capital Reserve such that, within 12 years, the annual contribution is equivalent to the annual amortization charge for assets supported by property taxes

   b) When a new capital asset funded by property taxes comes into service, an amount equivalent to the asset's amortization charge be transferred annually to the Tax Capital Reserve to prepare for the asset's eventual replacement

   c) Incorporate asset renewal and replacement charges into user fees as appropriate

   d) Limit annual debt payments to 20% of the City's own source revenues

2. That existing financing plans for the City of Barrie's portion of two significant community projects be revised as follows:

   a) That Barrie Hydro Holdings Incorporated (BHHI) be directed to re-invest dividends received from PowerStream into PowerStream Solar in accordance with the terms of the Subscription Agreement dated November 23, 2010

   b) That additional financing which may be required to fulfill the terms of the Subscription Agreement be provided as a loan to BHHI, on terms and in a form satisfactory to the Director of Legal Services

   c) That any dividends received from PowerStream following the fulfillment of the Subscription Agreement be applied first to any outstanding loans receivable and then to the Tax Capital Reserve.

   d) That the remaining $5.2M required to fund the Royal Victoria Hospital Grant be funded from the Tax Capital Reserve

3. That revisions to the City's Financial Policy Framework as identified in Appendix A be approved

4. That Finance staff be directed to update the long range financial plan to establish affordability thresholds in accordance with the City's Financial Policies Framework to be used to support the annual capital planning process.

5. That the options identified to reduce tax related debt identified in FIN020-11 be received.

6. That the Mayor and City Clerk be authorized to execute any agreements required to put these recommendations into effect.

PURPOSE & BACKGROUND

7. The purpose of this report is to recommend changes to the corporation's Financial Policies Framework, present updates to the Long Range Financial Plan (LRFP) and discuss the corporation's financial condition. This includes:

   a) An analysis of new strategies that can strengthen the City's financial condition

   b) Revisions to the corporation's Financial Policies Framework to support the new strategies

   c) Proposed revisions to existing funding strategies for the City of Barrie's portion of two significant community projects - the RVH expansion and PowerStream Solar

   d) Options available for reducing debt, in accordance with Council's direction from its 2011 Business Plan deliberations.

8. It is a requirement that, in the first year of its term, Council review and revise, if appropriate, the corporation's Financial Policies Framework. However, Council may also further review and make revisions to the framework at any point in its term.

9. For the past several years various staff reports have discussed the corporation's financial condition in accordance with the Public Sector Accounting Board's (PSAB's) recommended practices for reporting a government's financial condition. Specifically, financial condition is assessed using the elements of sustainability, vulnerability and flexibility.

10. During the 2006-2010 term of Council, members of Council expressed concern about the implications of relying on debt financing for the corporation's capital program. When combined with new information presented about asset condition, new financial statement reporting requirements for tangible capital assets and ongoing interest in maintaining property tax rates at "affordable" levels, staff and Council collaborated to create the Financial Policies Framework and the LRFP.

11. The City of Barrie's LRFP, combined with its Financial Policies Framework, is recognized as a best practice model for municipalities. In 2010 The Municipal Finance Officers Association of Ontario (MFOA) published a guide for municipalities about how to develop and use a long range financial plan; Barrie's experience provided a comprehensive case study that was described throughout the guide. As well, staff have made presentations at various public sector conferences about the LRFP and the corporation's business planning framework.

12. Information from the LRFP and asset condition data indicates that the corporation cannot sustain both its future financial commitments and current services and service levels without an increase in revenues. More resources need to be applied to ensure the corporation's existing assets support the provision of service at desired levels over their projected useful lives. These insights were most recently reported in the 2011 Business Plan (p. 164). Overall, the corporation's sustainability – its ability to maintain existing financial and service commitments without increasing debt levels or taxes – is declining.

13. This report does not specifically address financial strategies associated with development charges reserves or growth management. While these are a key component of our financial

planning and an area with significant risk exposure, strategies relating to growth and supporting policy revisions will be addressed in conjunction with the financial planning work currently underway with respect to the annexed lands and intensification plans.

Purpose of a Long Range Financial Plan

14. The LRFP is a comprehensive plan that is used to guide decision making. It includes a set of strategies, principles and policies used in conjunction with a ten year financial projection for operating, capital and user rate budgets. At a minimum, the LRFP supports assessments of the financial impact that decisions can have on the City's financial condition, now and in the future.

15. The forecasting capability provided by the LRFP increases the potential for the City to manage and improve the City's financial condition and monitor the key elements of sustainability, vulnerability and flexibility. It also provides the capability to identify the relationship between service levels, spending levels and capital investment decisions on future tax and user rates.

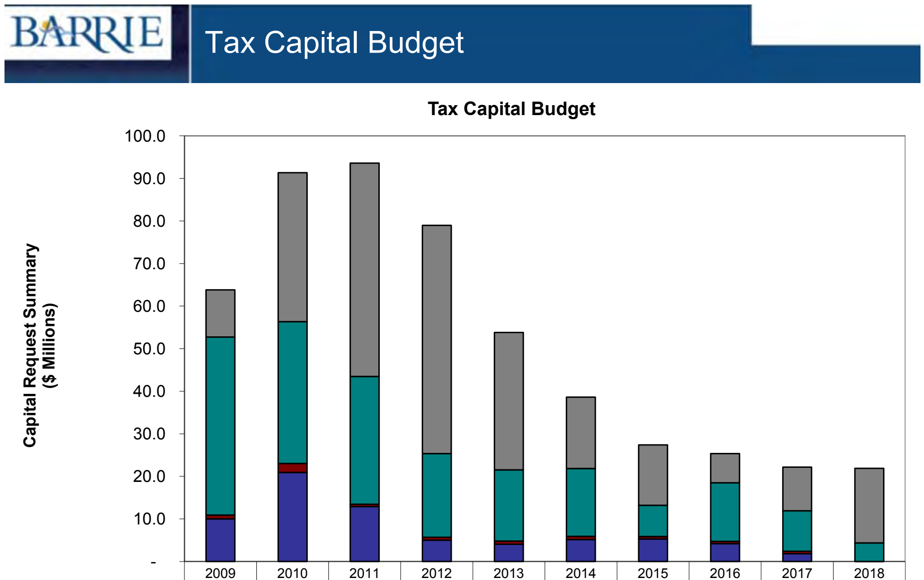
Improvements in Business Planning Drive the Quality of Long Range Financial Planning

16. When the LRFP was originally developed in 2009, it was understood that it would be a dynamic plan that would evolve as the quality and availability of data improved. Since then, the City's policy and planning framework has continued to evolve and significantly improve. For example, considerable progress has been made in understanding the condition of our assets and in our ability to prioritize asset investments. This improves our ability to identify maintenance and renewal requirements and/or new capital spending needs at levels which not only reflect the corporation's affordability limits, but also help maximize the useful life of the assets under our control.

17. A critical element affecting the quality of the LRFP forecasts is the capital plan. For example, the 2011 Capital Budget provides an achievable and affordable four year capital plan. The corporation's 10-year Capital Plan includes an additional six year forecast that incorporates renewal and replacement requirements based on expected useful lives and all requirements described in various master planning documents. This increases the accuracy and completeness of the LRFP forecasts, which improves its ability to guide decision making.

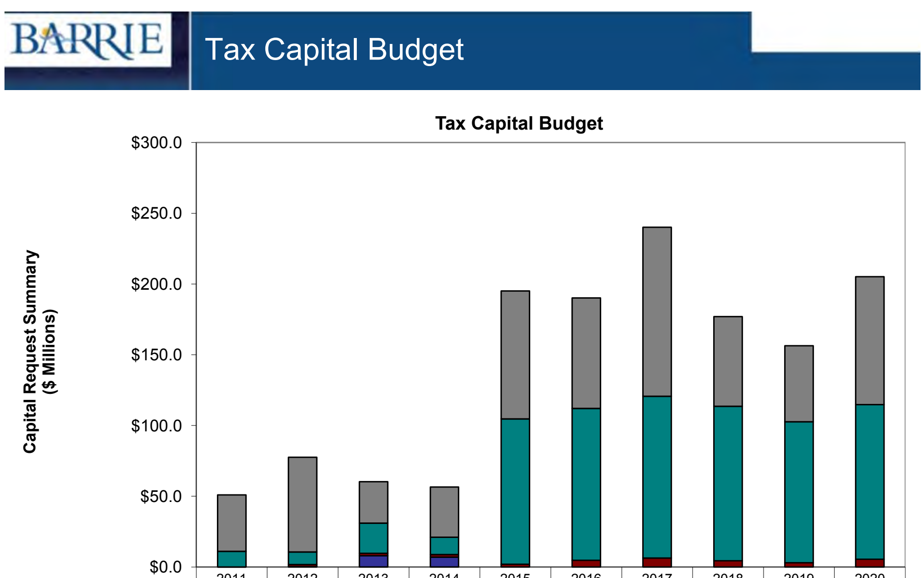
18. As a result of the evolution in capital planning since 2009 the corporation's capital budget and related financing requirements have changed substantially, as illustrated in the following graphs:

<u>Original LRFP Input: 2009 Capital Plan and Forecast</u>



	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Growth	11.1	35.0	50.1	53.6	32.3	16.8	14.2	6.9	10.3	17.5
Renewal	41.8	33.3	30.0	19.7	16.7	16.0	7.3	13.8	9.5	4.3
Corporate Initiatives	0.9	2.1	0.5	0.7	0.7	0.8	0.6	0.5	0.6	0.0
Strategic Priority	10.0	20.9	12.9	5.0	4.0	5.2	5.3	4.2	1.8	-

<u>Current LRFP Input: 2011 Capital Plan and Forecast</u>



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Additional Capacity	$39.8	$67.0	$29.2	$35.5	$90.4	$78.1	$119.5	$63.5	$53.7	$90.4
Renewal	$11.1	$8.9	$21.4	$12.3	$102.8	$107.3	$114.3	$109.1	$99.6	$109.3
Lifecycle Activity	$0.0	$1.6	$1.7	$1.8	$1.9	$4.7	$6.4	$4.5	$3.1	$5.5
Legislated Requirement	$0.0	$0.2	$8.0	$7.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0

The major factor influencing the differences illustrated by these two charts is staff's growing ability to apply the insights obtained from reviewing the LRFP. For example, in 2009 the Capital Plan and forecast reflected known renewal and additional capacity needs based on expected useful life, but it did not consistently reflect affordability limits. Now, in 2011, capital project prioritization activities are aligned with affordability limits established by legislation and the corporation's Financial Policies Framework. The result is a smaller, manageable capital program that defers some current needs to future periods, which in turn increases the risk of asset failure and increases the potential that existing service levels may not be maintained..

19. When the 2009 LRFP was adopted it was anticipated that tax rate supported debt as a percentage of the total capital plan would be reduced from 37% to 31%, that the peak in tax rate supported debt in 2014 would be reduced from $147 million ($1,010 per capita) to $132 million ($991 per capita) and that the tax rate supported debt charges as a percentage of the levy would be reduced from 11% to 10% in 2014 and 9.1% by 2018.

20. Given the substantial changes in the magnitude and timing of the capital requirements, it is unlikely these targets will be met. Based on the current 10 year capital plan and revenue projections, it is anticipated that the debt will peak in 2019 will represent approximately 12% of the total capital plan. However, this is not as a result of debt requirements being reduced, rather it is a function of the size of the capital plan in 2011 relative to 2009 forecasts and the fact that the primary source of funding for the additional capital requirements is the Tax Capital Reserve.

ANALYSIS

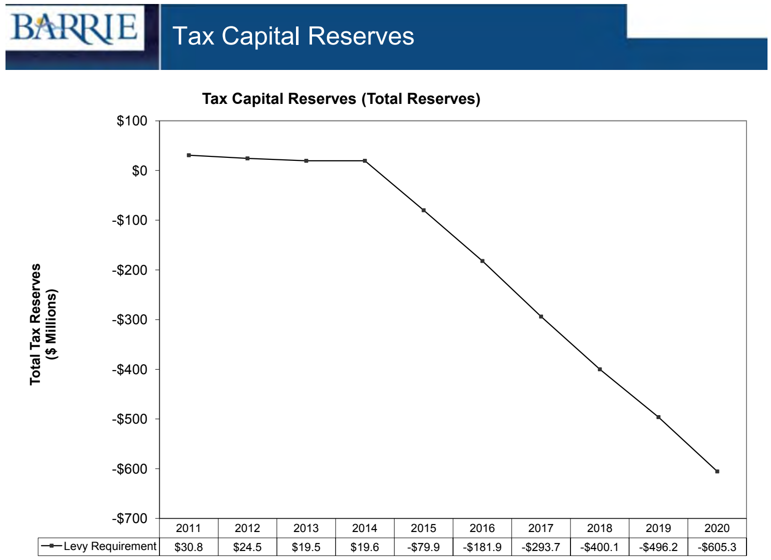
The City of Barrie's Financial Condition

21. The Financial Policies Framework provides guidelines that serve as business rules in the LRFP. Based on these rules and the projections provided by the LRFP, Council can assess current and future implications associated with its financing decisions. Annually, the Business Plan describes the corporation's financial condition based on current, approved financial policies and recommended services and service levels.

Sustainability

22. Sustainability is a government's ability to maintain current services and service levels without increasing property taxes or its debt burden. Since 2006 the corporation's sustainability has been declining. The community's growth over the last ten years has placed more demands on services and capital expenditures. Reliance on debt financing has increased the corporation's liabilities and has been consuming a growing share of total revenue.

23. An important strategy for reducing reliance on debt is to maintain healthy reserve balances. As illustrated in the projections from the Long Range Financial Plan, the Tax Capital Reserve is oversubscribed and will be depleted by 2014. The projections are based on the 2011 – 2020 Capital Plan, as such, they do not currently reflect recent discussions regarding the Police Facility requirements and the cost sharing issues relating to the Duckworth/400 Interchange.



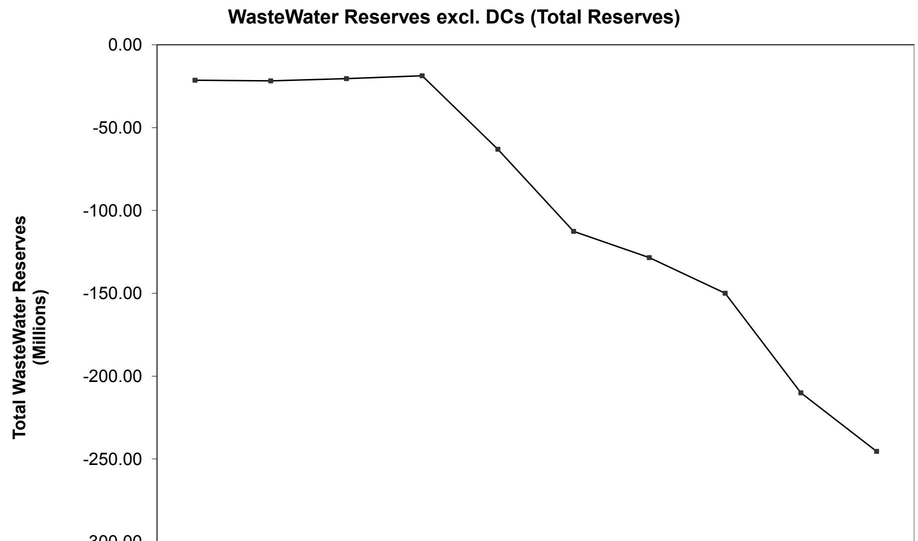
24. The corporation's financial policy framework establishes a minimum target balance for the Tax Stabilization Reserve of 5% of gross operating revenues. The current balance in the Tax Rate Stabilization Reserve is 3.16% of gross operating revenues.

25. The financial policy framework also establishes minimum target balances for water and wastewater stabilization reserves of up to ten percent of gross operating revenues. However, funding of these reserves has not yet commenced. Policy changes recommended in Appendix "A" address this gap.

26. In the City's 2010 water and wastewater six year financial plan, it was identified that annual revenue increases of 13% for water and 19% for wastewater are required over the next several years to build sufficient reserve balances. Subsequent to the completion of the six year financial plan, the capital plan evolved to reflect additional capital asset renewal needs and recoveries from the tax rate supported budgets were refined to more accurately reflect the staff time required to support water and wastewater operations. Also, given the timing of the development of the six year capital plan, operating costs for the Surface Water Treatment Plan were based on estimates.

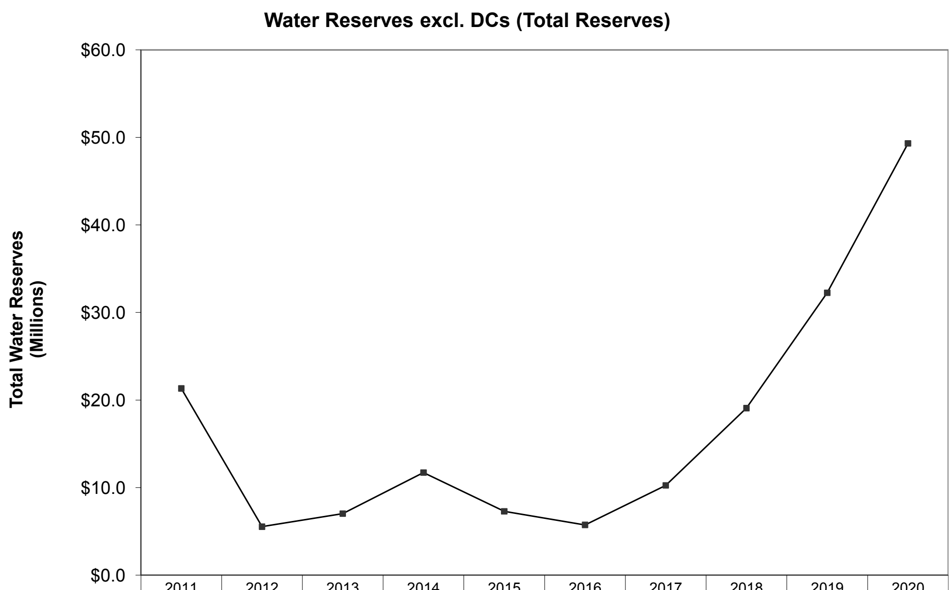
27. Given the additional information that is now available, the six year plans for water and wastewater will be updated in 2012. The sufficiency of the capital reserves and user rate requirements will be addressed at that time rather than in this report.

WasteWater Reserves excl. DCs (Total Reserves)



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
End Balance	-$21.4	-$21.8	-$20.4	-$18.7	-$63.0	-$112.6	-$128.5	-$149.9	-$210.1	-$245.4

Water Reserves excl. DCs (Total Reserves)

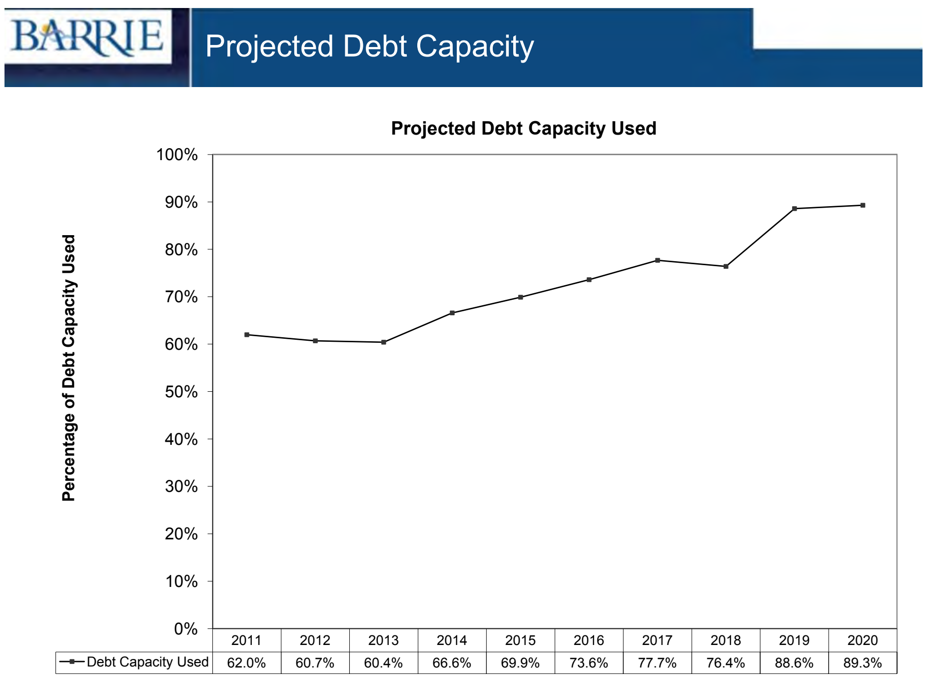


	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
End Balance	$21.3	$5.5	$7.0	$11.7	$7.3	$5.7	$10.3	$19.1	$32.3	$49.3

28. Similarly, Reserve Funds that rely on dedicated revenue streams, like the Development Charges Reserve Fund are below planned levels because the development activity that would trigger the contributions has not been occurring at the rate that was expected when the budget was set, and discounted rates approved by Council have reduced the amount of revenue earned from development activity. Since the 2008 Development Charges By-law update, only 75% of the

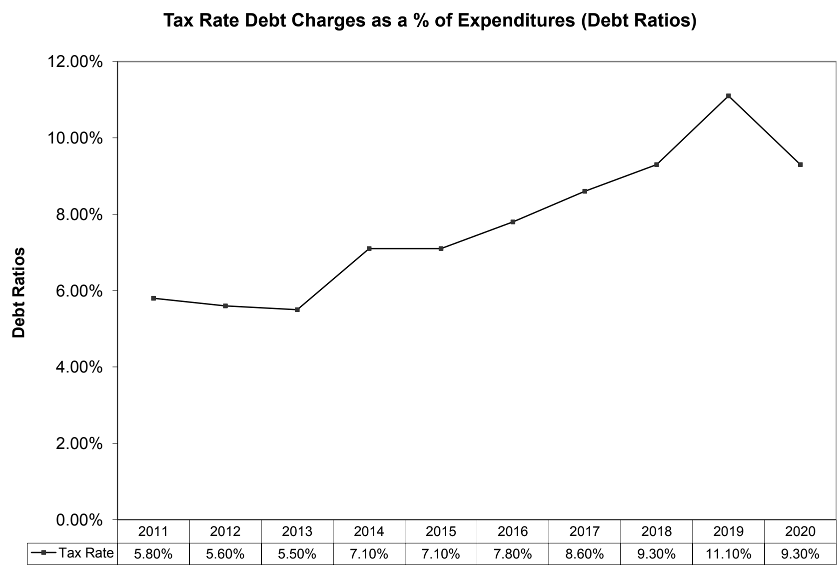
planned development charges revenue has been collected and the costs of the works are increasing due to inflation and refined cost estimates. As previously indicated, recommendations relating to development charges will be incorporated into the financial planning work currently underway as part of the intensification and annexed land planning.

29. The Province regulates the amount of a municipality can issue by limiting the annual debt payment amount to 25% of own source revenues. Currently, the annual debt payment amount represents 15.5% of Barrie's own source revenues or 62% of its available debt capacity. Total debt currently outstanding is $186 million. Debt financing that has been committed but not yet issued is an additional $175 million, for a total commitment of $361 million.



30. Debt charges in for tax rate supported services currently represent 5.8% of expenditures but is expected to peak in 2019 at 11%.

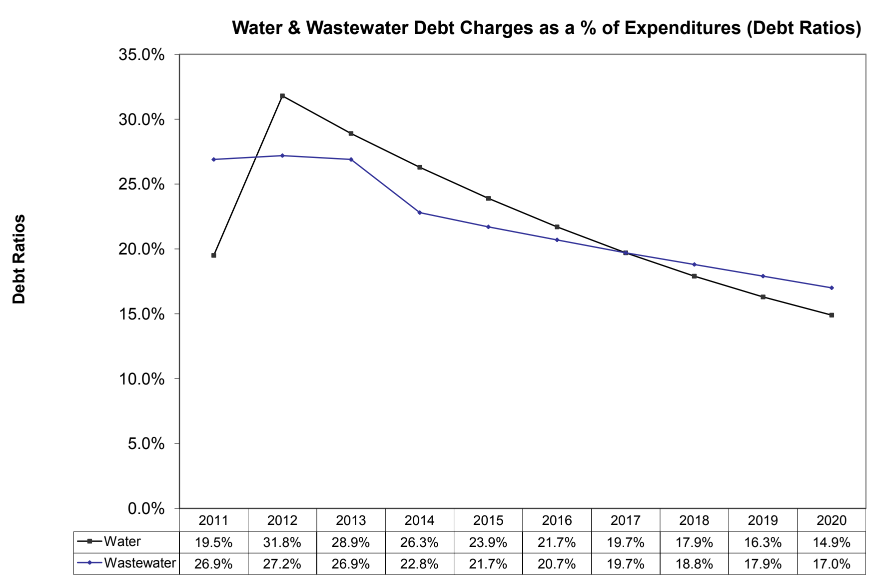
BARRIE **Tax Rate Debt**



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Tax Rate	5.80%	5.60%	5.50%	7.10%	7.10%	7.80%	8.60%	9.30%	11.10%	9.30%

31. Debt charges in user-rate supported services are higher over the same period, with water debt consuming 20% of expenses in 2011 and wastewater debt consuming 27% of related expenses. When the remaining debt relating to the SWTP is issued in 2012, debt charges for water will peak at 32% of expenses.

BARRIE **Water & Wastewater Debt**



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Water	19.5%	31.8%	28.9%	26.3%	23.9%	21.7%	19.7%	17.9%	16.3%	14.9%
Wastewater	26.9%	27.2%	26.9%	22.8%	21.7%	20.7%	19.7%	18.8%	17.9%	17.0%

32. Generally, options that improve Sustainability reduce the corporation's reliance on debt financing. As described in Appendix "A", proposed policy revisions include several changes that can reduce debt financing requirements and improve Sustainability. However, it is important to recognize that it will take several years of following these policies to achieve this outcome.

Flexibility

33. Flexibility is the degree to which a government can increase its financial resources to respond to rising commitments by either expanding its revenues or increasing its debt burden. Since 2006 the corporation's flexibility has remained stable and represents a strength for the corporation.

34. Property tax and user fee increases since 2006 are well below the thresholds Council identified in the Financial Policy Framework. The property tax and user fee increases approved in 2011 continue this stable trend.

35. Operational decisions may also influence Flexibility. For example, the extent to which maintenance is deferred on capital assets may create short-term savings in maintenance costs. However, this could lead to higher costs in the long-term as assets wear out prematurely or incur higher repair costs just to keep them in use for the duration of their expected useful lives. Staff considered this when preparing both maintenance budgets and the capital plan for 2011, emphasizing asset maintenance and renewal investments. The Capital Plan development process will be placing an emphasis on the importance of life cycle cost analysis.

36. The recommended policy changes in Appendix "A" help maintain the corporation's Flexibility. They also illustrate the interrelated nature of the elements of a government's financial condition. That is, by improving Sustainability, Flexibility is also maintained or enhanced. Without policy changes that improve Sustainability, Flexibility will also erode over time.

Vulnerability

37. The third element of financial condition is vulnerability. It is the extent to which a government becomes dependent on, and therefore vulnerable to, funding from senior levels of government over which it has no control.

38. The availability of funding from senior governments must be assessed in the context of the long-term financial implications associated with receiving it. There is a risk that service levels become artificially inflated unless a long-term funding plan exists to sustain the service without support from senior governments. For example, the benefit of funding which subsidizes the purchase of a capital asset (eg buses, or a recreation facility) needs to be weighed against the costs that will be incurred to operate, maintain and eventually replace the asset over its useful life.

39. The availability of reserves and reserve funds helps manage the risk that funding from senior governments artificially inflates service levels. Unfortunately, Barrie's reserve and reserve fund levels are too low to support required asset renewal investments for existing assets.

Proposed Strategies to Improve Financial Condition

40. Building reserves is a critical component of the LRFP as they can be used to provide stability to tax and user rates by smoothing variable or unanticipated factors and provide funding for one time or short term requirements. Reserves are also used to provide for replacement or acquisition of capital assets and to provide the flexibility to manage debt to stay within the debt policy limits.

41. As described in the previous section, the City's reserves are not adequate to meet future needs, therefore, the proposed strategies are targeted primarily at building reserves, which in turn will improve the City's flexibility to manage debt within debt limits and to protect the City's credit rating.

42. The following strategies to improve the City's financial condition are being proposed:

a) **Increased contributions:** The introduction of the tangible capital asset reporting requirements and the asset condition work completed over the last three years has lead to a greater understanding of the level of investment required to maintain the City's current asset portfolio. In 2010, the annual amortization for tax rate supported assets was $22.8M. Amortization can be thought of as a measure of how much we are using up of our assets each year. It will continue to increase as new infrastructure is added to the City's portfolio.

In 2011, the City is contributing $14.4M to the Tax Capital Reserve, an increase of $3.1M over the previous year. However, the estimated amortization for tax support assets in 2011 is $23M representing a difference of approximately $8.6M.

There is a direct connection between annual amortization and contributions to reserves as amortization reflects the amount that an asset is used in a year and the contribution to reserve is a savings plan with the objective of having sufficient funds available when it comes time to replace that asset. As such, it is recommended that a commitment be made to a twelve year phase in plan to ramp up contributions to reserves until they are equal to annual amortization. It is estimated, based on an annual shortfall of $8.6M, this would equate to an annual tax rate increase of approximately 0.5% based on current tax levels.

In order to ensure that the objective of having the annual contribution to reserve be equivalent to annual amortization by 2023, it is also recommended that when a new asset comes into service, the contribution should be increased by the annual amortization for that asset.

Using these two approaches, the average yearly increase to the Tax Capital Reserve would be approximately $1.5M, representing an annual tax rate increase of 0.9% while still remaining within the property tax affordability ratio of 4%.

b) **Incorporate Capital Contribution in User Fees:** The City's current financial system does not support activity based costing which is crucial for efficient, timely and accurate calculation of full costs including a capital contribution for amortization. However, some progress has made in determining full costs of specific services and moving forward will be used to incorporate a capital contribution for future fee structures

c) **Increase allocation of surplus to Tax Capital Reserves:** The financial policies framework currently indicated that any tax rate operating surplus be allocated 50% to the Tax Rate Stabilization Reserve and 50% to the Tax Capital Reserve. It is recommended that the allocation of tax rate supported operating surpluses be revised to 30% to the Tax Rate Stabilization Reserve and 70% to the Tax Capital Reserve.

The impact of this change will not be visible in the LRFP because in order to maintain a conservative approach to financial planning, it has been assumed that there will be no significant surpluses. However, this approach will help to address the inflationary impact will occur as a result of funding reserves at historical cost levels rather than replacement cost.

d) **Establish Planned Contributions to User Rate Stabilization Reserves:** As part of the BMA recommendations in 2009, user rate stabilization reserves were established to fund revenue shortfalls resulting from less than anticipated consumption or unanticipated expenditures, however, there is no strategy currently in place to fund them.

Given that the existing water reserve is not sufficient to meet the known infrastructure renewal requirements and the wastewater reserve is currently in a deficit position it is not feasible to transfer any portion of the existing reserves to the rate stabilization reserves. Instead, it is recommended that the rate stabilization reserves be funded by allocating 30% of any year end surpluses to the rate stabilization reserves and the balance being allocated to the Water and Wastewater capital reserves respectively.

e) **Reduced Debt Capacity Limit:** In 2011, the City's AA credit rating with a stable outlook was confirmed by Standard and Poor's, however, consistent with previous years assessments, Standard and Poor's continues to be concerned about the City's growing debt position as it compares to revenues. While they felt that the growth potential and resulting increases in property taxes made possible by the recent annexation could restore the relationship of debt to revenues to a level closer to the City's peers, they indicated that the AA stable rating reflected their expectation that the City would manage its Capital Plan and maintain debt forecasts that do not vary substantially from current forecasts.

While it is difficult to quantify the impact of a downgraded credit rating it is estimated that the cost of borrowing may increase between 0.4% and 0.7%. The estimated impact on the net tax levy would be between $22M and $39M over the next 10 years.

The City's debt capacity currently peaks at 22.5% in 2020. Provincial guidelines require that annual debt payments not exceed 25% of a municipalities own source revenue, however, in order to protect the City's credit rating, it is recommended that the annual debt payments be limited to 20% of the City's own source revenues. This means that the debt forecasts for 2018 – 2020 would need to be revised as the current plan would result in the proposed 20% limit being exceeded.

Introduction of Affordability Thresholds to Capital Planning Process

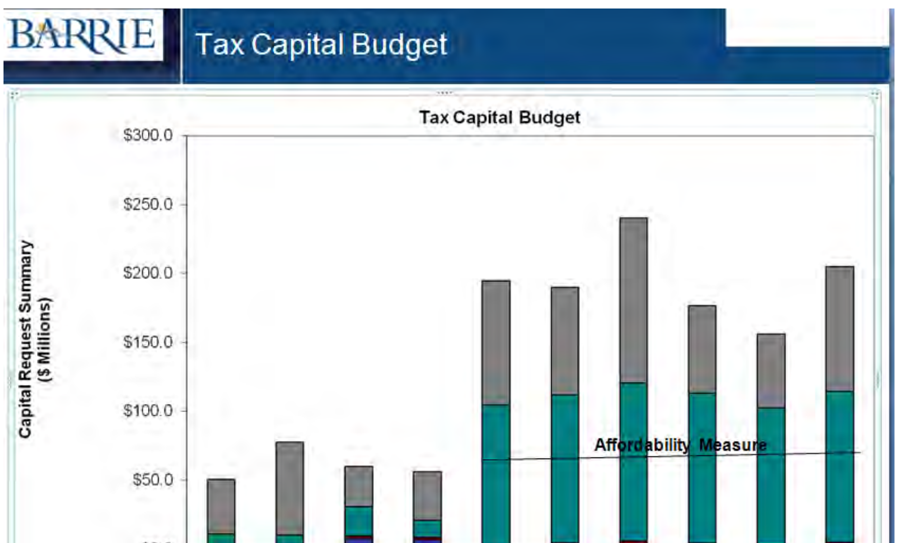
43. The proposed strategies identified above focus on building reserves and reducing the City's reliance on debt, however, these strategies need to be applied in conjunction with strategies to support the development of affordable capital plans.

44. The improvements made to the corporation's business planning process have been critical for staff to develop insights about the corporation's financial condition and recognize a number of issues that need to be managed. Thanks to the policy guidance provided by the Financial Policies Framework and the forecasts provided by the LRFP, staff can also estimate the time available before risks become realized. For example, as previous reports have discussed and this report illustrates, the corporation will have depleted its Tax Capital Reserve by 2014. This means that beyond 2014 the capital plan will have to be scaled back, more debt financing will be required, and/or alternate forms of service delivery need to be explored to provide funds for projects that would have otherwise been funded by the Tax Capital Reserve. As the analysis in this report shows, the corporation also risks increasing the size of its "infrastructure deficit" when it expends funds on new capital assets before it addresses all of the renewal needs that must be addressed to keep existing assets in a state of good repair.

45. These insights suggest it is necessary to change the corporation's approach to long range financial and capital planning. Currently, and appropriately, capital plans reflect guidance from master plans and asset management data and show the cost of all known service needs for the next ten years. When it comes to building a financing plan, however, affordability constraints limit our ability to deliver all of the projects in the capital forecast. Therefore, staff propose that a long range financial plan be developed that establishes affordability thresholds for capital spending based on reserve levels and debt capacity availability and in accordance with the Financial Policies Framework.

46. These affordability thresholds would be used to support the capital planning process. Specifically, staff recommend the first four years of a 10-year capital plan reflect the affordability thresholds. The remaining six years of the capital plan, however, would still reflect all known additional capacity and renewal needs based of expected useful life of the City's assets and master plans and be used as the starting point for the prioritization process each year.

47. The graph below provides an indication of how the affordability threshold would be applied. This is based on the average spending on the current four year plan but would need to be refined to reflect the City's financial policy framework principles and targets and the debt capacity limits.



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Additional Capacity	$39.8	$67.0	$29.2	$35.5	$90.4	$78.1	$119.5	$63.5	$53.7	$90.4
Renewal	$11.1	$8.9	$21.4	$12.3	$102.8	$107.3	$114.3	$109.1	$99.6	$109.3
Lifecycle Activity	$0.0	$1.6	$1.7	$1.8	$1.9	$4.7	$6.4	$4.5	$3.1	$5.5
Legislated Requirement	$0.0	$0.2	$8.0	$7.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0

48. Each year, the fourth year of the four year plan would be prioritized using the optimized decision making framework already in place and the most updated asset management information available at that time. For instance, included in 2015 may be assets that are scheduled for replacement based on their age, however, it may be that they are still performing at acceptable levels and therefore replacement could be deferred to future years.

49. Staff believe this is a reasonable and prudent approach for managing limited financial resources. It also helps manage expectations about the timing and level of anticipated service enhancements throughout the 10-year forecast period.

50. **Other Strategies Considered But Not Recommended**

a) **Liquidation of the $20 million promissory note from PowerStream:** The promissory note is currently earning interest at 5.58%. Based on Infrastructure Ontario's current lending rates, the cost of borrowing is interest of 3.38% for a ten year term and 4.12% for a twenty year term, therefore the option to liquidate the promissory note is not recommended at this time. Staff will continue to monitor interest rates and report back to Council if the relationship between investment earning and cost of borrowing changes.

b) **Use of a Capital Levy:** Several municipalities were contacted to identify the extent to which separately identified capital levies were being used. Generally speaking, most municipalities included a contribution to reserves from their operating budgets but relatively few were separately identifying the levy on the tax bills. Rather than utilize a capital levy it is recommended that a communication plan be developed that clearly identifies the portion of the property taxes that support asset renewal activities and the importance of doing so.

Funding Strategy Revisions

Green Energy Project

51. As described in CRP006-09, the City is participating in the PowerStream Green Energy Project ("PowerStream Solar"). At that time, it was anticipated that Barrie's funding commitment of $12.3 million would be funded from the Tax Capital Reserve.

52. PowerStream Solar is supported by an agreement between PowerStream's shareholders. Therefore, it is recommended that the funding strategy be revised to have BHHI re-invest the PowerStream dividends into this project along with the proceeds from the sale of the water heater business that is anticipated later this year. Any discrepancies between the dividends and the timing of the funding requirements for the project would be addressed by establishing a short term loan agreement between the City of Barrie and Barrie Hydro Holdings.

53. Current projections indicate that the full investment of $12.3M will be required by the end of 2013 and that the dividends relating to PowerStream Solar will begin in 2014. Barrie Hydro Holdings has already contributed $886,800 to the Project. Based on projected PowerStream dividends in the amount of $5,647,750 for 2012 and 2013 combined with the anticipated pre-tax proceeds from the sale of the water heater business of approximately $830,000 it is anticipated that the total loan requirement would not exceed $5M. Current projections indicate that any loans established could be fully paid by the end of 2015.

54. Once Barrie Hydro Holding's funding commitment is fulfilled, dividends declared would first be applied to any loan amounts outstanding and then be allocated to the Tax Capital Reserve.

Royal Victoria Hospital

55. In 2009, the strategy developed for funding the RVH grant was to allocate the PowerStream dividends to the RVH Reserve with the objective of meeting the full commitment by 2012. The total commitment to RVH is $52.5M. Considering payments made to date of $5.3M and the balance in the reserve is $42M, an additional $5.2M is required. Given that the re-investment of the hydro dividends into a hydro related project is a more logical fit, it is recommended that the remaining funding commitment of $5.2M be funded from the Tax Capital Reserve.

Financial Policy Framework Update

56. Proposed revisions to the City's Financial Policy Framework Update have been provided in Appendix A. The objective of the proposed changes are to improve the City's financial condition by building reserves, protecting the City's credit rating by limiting the level of new debt and increasing non-tax revenues. The revisions will also improve the degree of guidance provided when making financial decisions. The highlights and a brief description of the proposed changes are identified below:

    a) **Asset Management:** It is recommended that this policy be repealed as a new Corporate Asset Management Policy is being developed by the Corporate Asset Management Department

    b) **Growth and Development:** This policy will be revised once the intensification and annexation studies are complete.

    c) **Debt:** Additional guiding principles have been established to clarify the circumstances under which debt should be issued and to formalize the City's approach of ensuring that 50% of the annual debt charges should be included in the current operating budget in order to smooth tax rate/user rate increases. The policy has also been updated to reflect a revised debt capacity limit which limits the annual debt charges to 20% of the City's own source revenues.

    d) **Investments:** Changes to this policy have been deferred until 2012 so that they can be reviewed in conjunction with a broader investment strategy development initiative.

    e) **Operating Surplus/Deficit:** Proposed changes are to clarify the use of the Tax Rate Stabilization Reserve and to establish that any surplus amounts not required to meet the Tax Rate Stabilization reserve target will be allocated to the Tax Capital Reserve.

    f) **Budgeting:** Proposed changes are to formalize and reflect current practices.

    g) **Revenue – User fees and service charges:** Proposed changes are intended to clarify the City's intent to set fees at full cost recovery levels and to incorporate an asset renewal replacement component to fees where appropriate to assist in building capital reserves.

    h) **Revenues – Property Taxation:** Proposed changes to the property taxation policy are primarily housekeeping related in order to incorporate the affordability targets established in 2009 and to utilize the Long Range Financial Plan as the basis for annual tax increases as it is a more reasonable target than the Consumer Price Index or Construction Price Index given the unique nature of the City's expenditures.

    i) **Revenues – Non-recurring revenues:** Proposed changes to this policy are intended to reflect the importance of evaluating the longer term financial implications of receiving and utilizing grants from senior levels of government.

    j) **Financial Position**: No changes are being proposed at this time.

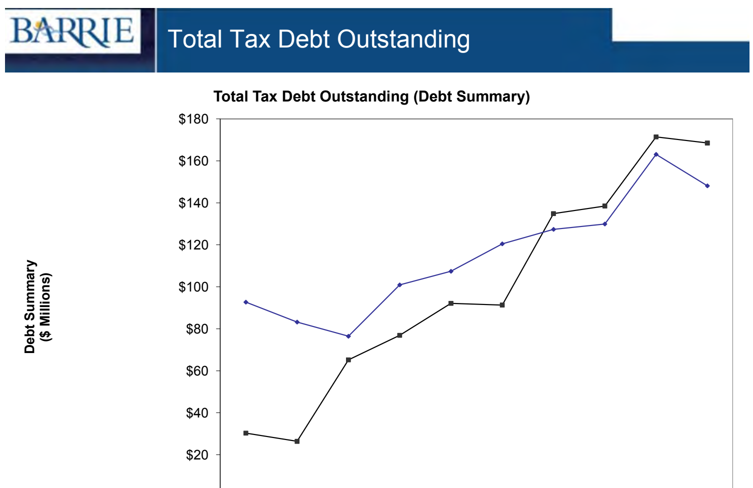
    k) **Reserve/Reserve Fund Management:** This policy has been updated to reflect the recommendation to phase in increased contributions to the Tax Capital Reserve with the objective of reaching a contribution level equivalent to amortization within twelve years and to increase contributions to reserves in an amount equivalent to the annual amortization for all new assets when they come into service. By using this approach, targets relating to various triggers for increased contributions to the tax capital reserve can be removed. The recommendation to set the allocation of surpluses to tax and user rate stabilization reserves and capital reserves to 30% and 70% respectively.

Options for Reducing Tax Rate Supported Debt

57. As part of the 2011 Business Plan deliberations, staff were directed to investigate options that would reduce tax rate supported debt by as much as 50% from 2012 - 2014.

58. For context, the debt projections that have been provided in annual business plans have been based on when debt is anticipated to be placed which was typically a year following the completion of the project. The capital planning process, which drives the long range financial plan, captures debt using a spending plan approach. From this point forward, debt forecasts will be expressed based on the spending plan approach for consistency and to more accurately reflect the debt commitment.

59. The following graph illustrates the impact on previously reported debt forecasts. At the outset, debt levels appear higher but eventually line up after three to four years which generally reflects the length of time to complete a significant capital project.



	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
2011 Business Plan Binder	$30	$26	$65	$77	$92	$91	$135	$138	$171	$168
Debt Issued as Costs Incurred	$93	$83	$76	$101	$107	$120	$127	$130	$163	$148

60. For this exercise, the starting point for tax rate supported debt reduction is based on the 2012-2014 debt forecasts presented in the 2011 Business plan of $89M therefore, a reduction in 50% of debt would be equivalent to $44M.

61. In accordance with the Municipal Act, 2001 and related regulations, the City's debt capacity is recalculated each time Council approves a motion to fund a project by debt. The current debt capacity is 62% and includes projects listed in Appendix B The debt capacity does not include forecasted projects that have been included in the Capital Plan unless Council has pre-approved the use of debt for a particular project.

62. The largest debt financed projects in the 2011 – 2020 Capital Plan with the greatest degree of flexibility for deferral are the Transit Garage, Police Headquarters and Station works and the Allandale Station. Combined, these projects represent approximately $34.8 million or 40% of the forecasted debt over the next three years.

Project	Level of Debt Financing	% of total debt 2012-2014	Total Forecasted Debt for the Project
Transit Garage	$10.94M	12.4%	$11.16M
Police Headquarters and Station Works (Note 1)	$15.32M	17.4%	$24.47M
Allandale Station	$ 8.6M	10%	$8.6M
Total	$34.8M	40%	$44.23M

Note 1: The debt financing identified for the Police Headquarters and Station Works represents what is currently included in the 2011-2020 Capital Plan for renovations to 29 Sperling, 60 Bell Farm Rd and 79 Bell Farm Rd. It does not reflect and discussions that have occurred since the approval of the 2011 Business Plan..

63. Other projects such as transportation related works on Essa Road, Harvie Road and in the Duckworth and Cundles area have a much lower degree of flexibility for deferral largely as a result of being driven by development. The timing of the related developments could however, change and would result in an opportunity for deferring the City's capital works that are necessary for the developments to proceed. The Landfill Re-engineering and the construction of Fire Station 5 are also viewed as having a much lower degree of flexibility for deferral.

64. To achieve a 50% reduction in forecasted debt over the next three years, projects that are not currently being funded through the issuance of debt would need to deferred which would allow the Tax Capital Reserve funding from those projects to be re-allocated to debt funded projects. This would result in the deferral of additional capacity driven projects that are intended to address current service deficiencies that exist. Projects such as the expansion of Mapleview Drive and Ferndale Drive are intended to address transportation service deficiencies in their respective areas. Deferring either or both of these would result in significant amounts of Tax Capital Reserve funding becoming available to re-allocate to address debt funded projects. As previously noted however, this would result in deficiencies in the City's transportation service continuing and perhaps worsening. It is not recommended to defer proposed works related to the renewal of existing assets given the rate of deterioration that is currently being experienced.

65. Use of the Provincial and Federal Gas Tax to replace debt was also considered. The Provincial Gas Tax is only to be utilized towards transit is currently being optimized in alignment with funding program guidelines to increase ridership. The Federal Gas Tax is currently being used to fund road renewal activities, address the in excess of $100 million storm drainage issues as well as the Landfill Re-Engineering project that is otherwise funded through the issuance of debt. The strategy for allocating federal gas tax has been to apply it to lifecycle activities first and then capital projects that can easily meet the program criteria. Any amounts remaining have already been used to reduce the debt on the Landfill Re-Engineering project, therefore, it is felt that there is limited opportunity for reallocation of these funds.

ENVIRONMENTAL MATTERS

66. There are no environmental matters related to the recommendation.

ALTERNATIVES

67. There are four alternatives available for consideration by General Committee:

Alternative #1

General Committee could maintain the existing Financial Policies Framework.

The current Financial Policies Framework represents a best practice in municipal financial planning. Collectively, however, the policy limits it provides are not sustainable based on the corporation's current services, service levels, known asset management and renewal requirements and growth related infrastructure needs. The recommendations in this report reflect initial steps to improve the City's financial condition.

Alternative #2

General Committee could maintain the existing funding strategies for the PowerStream Solar and Royal Victoria Hospital projects.

Although this alternative is available, it is not recommended. The re-investment of hydro dividends into a hydro related project is a logical financing plan. The Tax Capital Reserve is an appropriate funding source for funding the City's commitment to RVH that would not be addressed by the funds available in the RVH reserve.

Alternative #3

General Committee could alter the proposed recommendation by adopting a longer phase in period to increase contributions to the Tax Capital Reserve to the point where they are equivalent to annual amortization.

The proposed timeframe represents a reasonable balance between funding requirements and affordability. As circumstances evolve or Council's views on service priorities change, the duration of the phase-in period could change to incorporate new information or priorities.

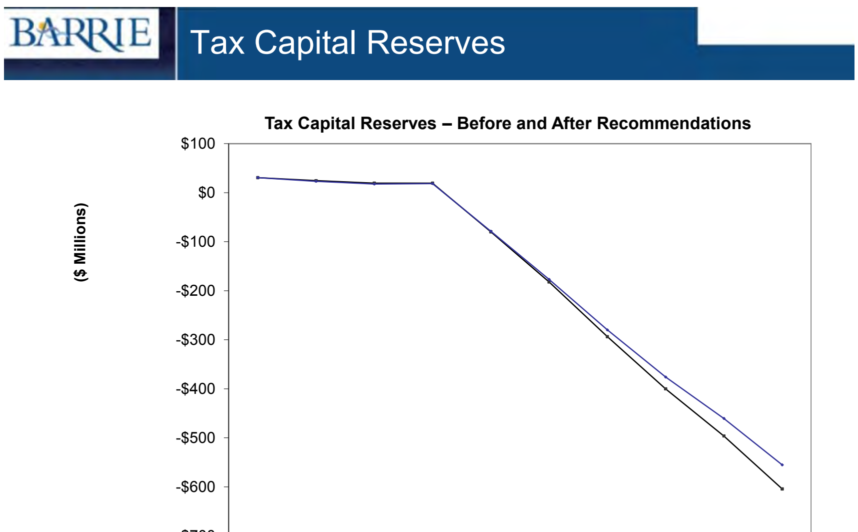
Alternative #4

General committee could maintain the existing debt capacity limit of 25% established by the Province.

Reducing the debt capacity limit to 20% is an effective strategy to reduce the City's reliance on debt, thereby taking steps to improve its Sustainability and Flexibility. This strategy is also intended to protect the City's current credit rating of AA stable..

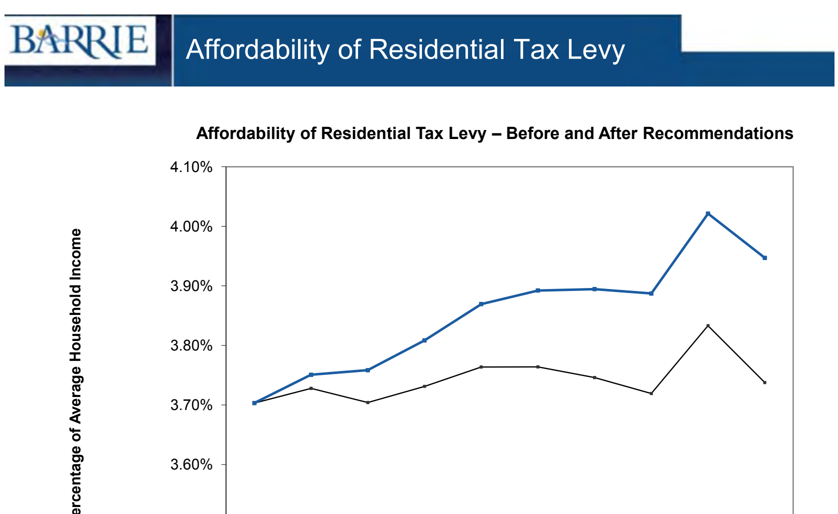
FINANCIAL

68. The strategies recommended will result in a net increase to the Tax Capital Reserve by 2020 of $50M. The strategies relating to increasing the contribution to reserves result in an increase of $65M over the ten years, however, this is offset by the recommendation to re-invest the PowerStream dividends into the PowerStream Solar project and to fund the remaining RVH grant from the Tax Capital Reserve.



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Status Quo	$30.8	$24.5	$19.5	$19.6	-$79.9	-$181.9	-$293.7	-$400.1	-$496.2	-$604.3
After Recommendations	$30.8	$23.2	$17.7	$18.5	-$78.6	-$176.9	-$279.9	-$376.0	-$460.4	-$555.1

69. The Financial Policies Framework includes a property tax affordability threshold of 4%. This ratio calculates the average residential property taxes as a percentage of household income. The recommendations were specifically designed to ensure that the affordability ratio remained within the established threshold as identified in the graph below.



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Status Quo	3.70%	3.73%	3.70%	3.73%	3.76%	3.76%	3.75%	3.72%	3.83%	3.74%
After Recommendations	3.70%	3.75%	3.76%	3.81%	3.87%	3.89%	3.89%	3.89%	4.02%	3.95%

70. The strategy to establish a debt capacity limit will result in the current projected debt capacity limit of 22.5% to be reduced to 20%. This approach will also provide guidance for future decisions relating to debt that will help to preserve or potentially improve the City's AA stable credit rating.

71. The revised funding strategies proposed will also achieve a better alignment between two significant projects in which the City of Barrie is an investor. Specifically, dividends from PowerStream would be directed to fund the City's investment in PowerStream Solar and the Tax Capital Reserve would be used to fund the remaining portion of the City's commitment to the RVH expansion.

LINKAGE TO 2010-2014 COUNCIL STRATEGIC PLAN

72. The recommendation(s) included in this Staff Report support the goal of strengthening the City's financial condition by establishing a reasonable and affordable set of strategies and policies that represent the initial step to ensure that the needs of the community can be met now and in the future.

APPENDIX "A"

Revisions to Financial Policies Framework

APPENDIX "B"

Projects with Approved Council Motions Included in the Calculation of Projected Debt Capacity

Project Name	Motion	Approved Amount
1 Dunlop St. W (Playhouse Theatre)	07-G-357	850,000
5 Dunlop St. W	08-G-077	100,000
Airport	09-G-310	4,233,400
Allandale Train Station	10-G-175	4,300,000
City Hall Electrical Upgrade	06-G-451	900,000
Collier St. Parking Garage	Issued	10,311,454
Cundles - Livingstone to Duckworth	11-G-014	2,868,000
Downtown Theatre	11-G-036	1,856,000
Duckworth - Cundles to Bernick	11-G-014	1,915,000
Fire Station 1 (Replacement)	09-G-310	4,666,600
GO Transit	Issued	5,415,887
Gowan Street/Go Platform	ENG052-10	3,662,818
Holly Recreation Centre	Issued	17,267,061
Kenneth Bertha Urbanization	Issued	11,290,107
Lakeshore Trunk Sewer Phase I & II	08-G-368	10,000,000
Landfill re-engineering Phase I	08-G-372	352,141
Local Improvements - Sewer	Issued	403,565
Local Improvements - Water	Issued	880,000
Operations Centre SWP	09-G-465	24,300,000
Oro-Medonte Biosolids facility	08-G-218	5,171,292
Pine Drive Ph III	10-G-086	1,520,845
Pine Drive Phase I Urbanization	07-G-588	1,734,000
Pine Drive Phase II Urbanization	08-G-391	345,000
Police - Purchase 35 Sperling Dr.	10-G-351	18,600
Sec 326 Ardagh Rd.	03-G-151	152,374
Sec 326 Ardagh/Crawford/Ferndale	04-G-345	556,000
Sec 326 Big Bay Pt. - Sewer	07-G-344	163,400
Sec 326 Big Bay Pt. - Water	07-G-344	552,257
Sec 326 Gray/Arbour - Water/Sewer	04-G-321	141,194
Sec 326 Gray/Arbour II - Sewer	06-G-355	1,527,685
Sec 326 Gray/Arbour II - Water	06-G-355	54,850
Sec 326 Little Ave.	03-G-182	470,000
Sec 326 Pine Dr Phase II - Sewer	08-G-391	673,536
Sec 326 Pine Phase I - Sewer	07-A-329	77,302
Sec 326 St Paul's - Sewer	06-G-347	35,963
Sec 326 St Paul's - Water	06-G-347	360,230
Sec 326 Tiffin - Water	07-G-467	10,000
Sec 326 Tynhead - Water Laterals	07-G-364	121,036
Sec 326 Veterans - Sewer	04-G-386	62,802
Sec 326 Veterans - Water	04-G-386	200,000
Sec 326 Yonge	02-G-096	150,000,000
SWTP and Low-Lift Pumping Station	08-G-165	10,250,000
Transit Garage	07-G-310	883,000
WPCP Expansion	07-G-658	81,000,000