The Regional Municipality of York

Committee of the Whole
Finance and Administration
December 12, 2019

Report of the Commissioner of Finance

2020 Regional Fiscal Strategy

1. Recommendations

1. Council adopt the updated fiscal strategy as outlined in this report.

2. Council authorize borrowing from the following reserves to repay tax levy and rate-supported debt originally intended to be refinanced in 2020:

Reserve	Amount
a. Debt Reduction Reserve	$9,585,954.80
b. Capital Asset Replacement – Water	$3,094,194.50
c. Capital Asset Replacement – Wastewater	$2,601,625.60

3. Council affirm the 2020 Long-Term Debt Management Plan included as Attachment 1 to this report.

2. Summary

This report seeks Council's approval of the update to the fiscal strategy whose principles have guided the preparation of the 2020 - 2022 Budget.

The fiscal strategy highlights an increased need for debt over the next 10 years due to lower than previously forecast development charges collections. It also notes that there is expected to be an increase of $240 million in asset management spending during the next 10 years as the departmental asset management plans are incorporated.

Furthermore, it recommends the early repayment of $15 million of tax levy and user rate debt that was planned to be refinanced in 2020 and advises the Region's credit rating outlook from S&P Global Ratings improved from Stable to Positive.

Finally, this report also seeks the adoption of the 2020 Long-Term Debt Management Plan which allows the Region to access a growth-related cost supplement for its Annual Repayment Limit (ARL).

3. Background

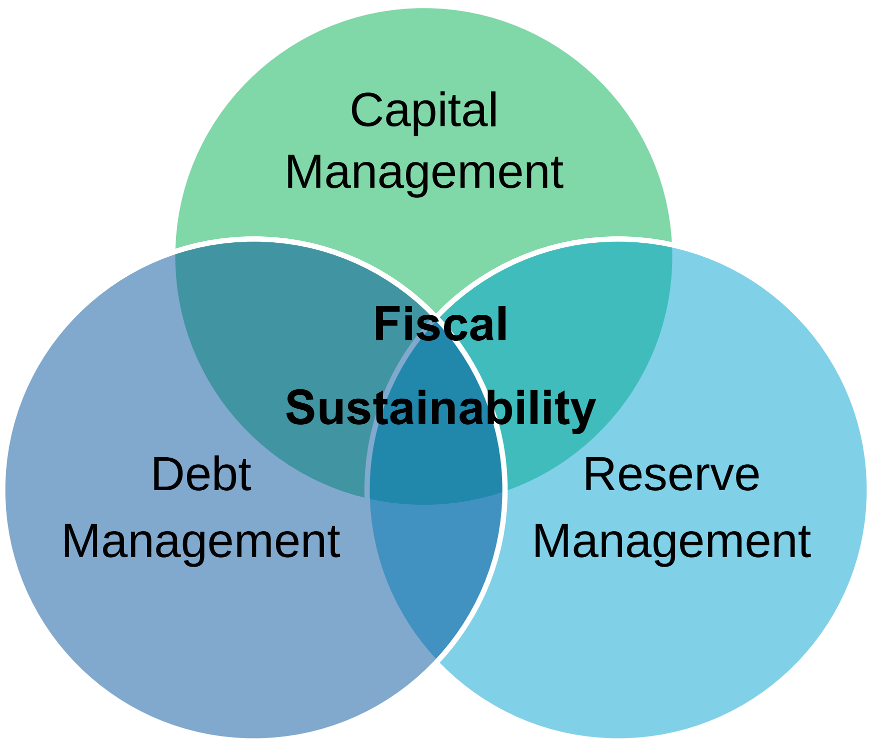
The 2014 Budget introduced the Region's first formal Fiscal Strategy

As part of the 2014 Budget, Council adopted its first formal fiscal strategy, which has been updated every year during the annual budget process. The last fiscal strategy was adopted by Council on February 28, 2019. This report can be found in item H of the Committee of the Whole on February 21, 2019.

The fiscal strategy has three elements which help achieve financial sustainability while striking the appropriate balance between the current and the long-term financial needs of the Region. These three elements work together by managing the capital plan, reserves and debt. These elements are shown in Figure 1.

Figure 1

Elements of the Fiscal Strategy



4. Analysis

Overarching the Fiscal Strategy is Intergenerational Equity

The fiscal strategy is based upon the principle of achieving intergenerational equity - no generation is left worse off through the actions of another. This principle guides various elements of the strategy and influences decisions about when infrastructure is built and how it is paid for.

The Region makes two types of infrastructure investments: those needed for asset repair and replacement and those needed to facilitate growth.

When applying the principle of intergenerational equity to funding decisions associated with asset replacement, the strategy recognizes that expenditures can vary significantly from year to year and that individual projects could occur many years into the future. To ensure each generation pays their fair share, annual contributions to reserves have been calculated using a very long time horizon – 100 years.

Also, debt is used to bridge the timing difference between when a growth-related asset is built and when it is eventually paid for through development charge collections, which can be years later. The principle of intergenerational equity requires that debt be maintained at a sustainable level, and growth infrastructure may need to be phased at a pace that more closely matches the natural rate of growth. Spending too far ahead of growth could leave the Region with too much debt and an asset base that needs to be maintained, while too little spending could slow the rate of growth.

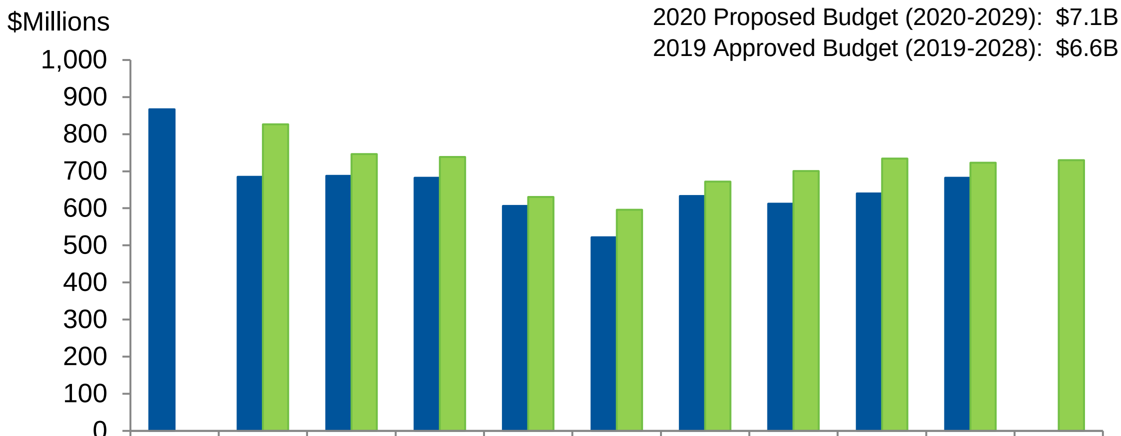
Applying the principle of intergenerational equity to the infrastructure program requires careful balancing of three separate streams of activities: managing the capital plan, using reserves to fund infrastructure investment and using debt, when appropriate. Achieving this balance without taking on excessive financial risk requires continuous monitoring. The remainder of this report discusses managing the capital plan, using reserves, and managing debt.

First Element of the Fiscal Strategy – Managing the Capital Plan

At $7.1 billion, the proposed 10-year capital plan is $479 million higher than last year, of which over half is due to an increased investment in asset management as shown in Figure 2. The capital plan includes approximately $4.0 billion for new growth-related infrastructure and approximately $3.1 billion for rehabilitation and replacement expenditures, as shown in Figure 3.

Figure 2

10-Year Capital Plan Comparison



	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
2019 Budget	866,692	685,026	687,166	682,463	606,586	521,666	633,004	612,607	640,218	682,516	
2020 Budget	0	826,322	746,337	738,430	630,854	596,090	671,869	700,592	734,186	723,201	729,427

Source: York Region Finance Department

The Region's approved asset management plan has been incorporated into the fiscal strategy

Since 2015, a major initiative has been underway to more precisely forecast the Region's long-term asset management needs. All departments have completed asset management plans and those are now fully reflected in the current capital plan.

Over the next 10 years, asset management spending is expected to be $240 million higher than shown in last year's budget. The need for this increase has been highlighted in prior budgets.

As shown in Figure 3, most of the asset management spending, or $2.8 billion, will be funded from asset replacement reserves, while the remaining $300 million will be funded from other tax levy reserves and grants.

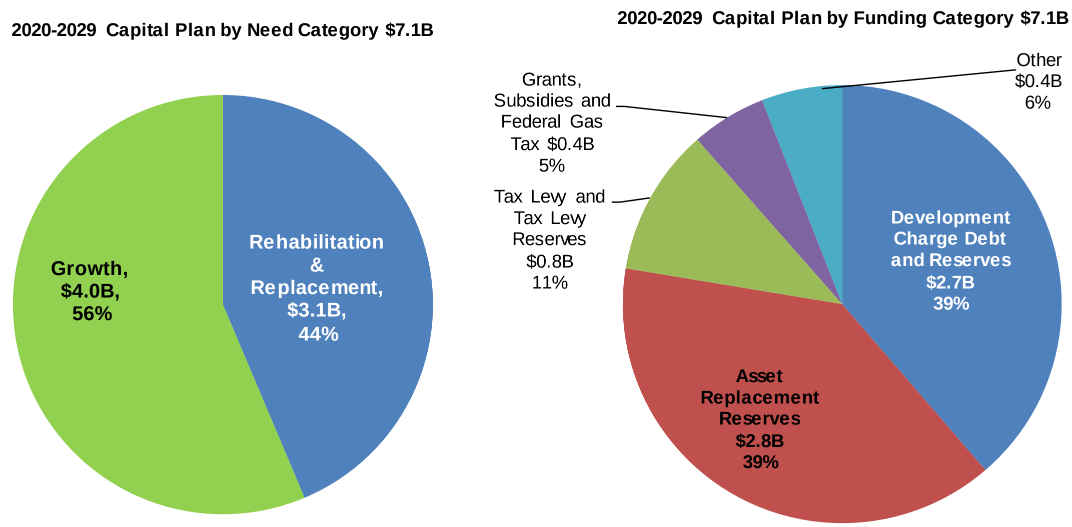
The Region continues to make significant investments in growth-related capital

The $4.0 billion of growth-related infrastructure accounts for 56 per cent of the expenditures in the 10-year capital plan, as shown in Figure 3.

$2.7 billion of this $4.0 billion will be funded from development charges. The remaining portion will be funded from tax levy reserves and through the use of the Federal Gas Tax and provincial grants.

Figure 3

Growth and Rehabilitation Expenditures and Funding Sources from 2020-2029



Source: York Region Finance Department

Capital management involves aligning the timing of infrastructure investment with the pace of growth and development charges collections.

Growth-related infrastructure provides vital services to support new population and employment. However, growth-related infrastructure is expensive, and often requires debt financing. To ensure financial sustainability, the capital plan must be managed to achieve a balance between providing sufficient capacity to grow, and limiting the amount of unused capacity.

Municipalities in the Greater Golden Horseshoe are mandated to adopt Official Plans that conform to the provincial Growth Plan targets. The infrastructure master plans prepared by municipalities are designed to meet the needs of the population in the Official Plan. The Region's capital plan implements its master plans and provides the spending authority to build those projects. From 2016 to 2041, the Region is forecasted to contribute 20 per cent of population and 26 per cent of employment growth, the highest share amongst the Greater Golden Horseshoe municipalities.

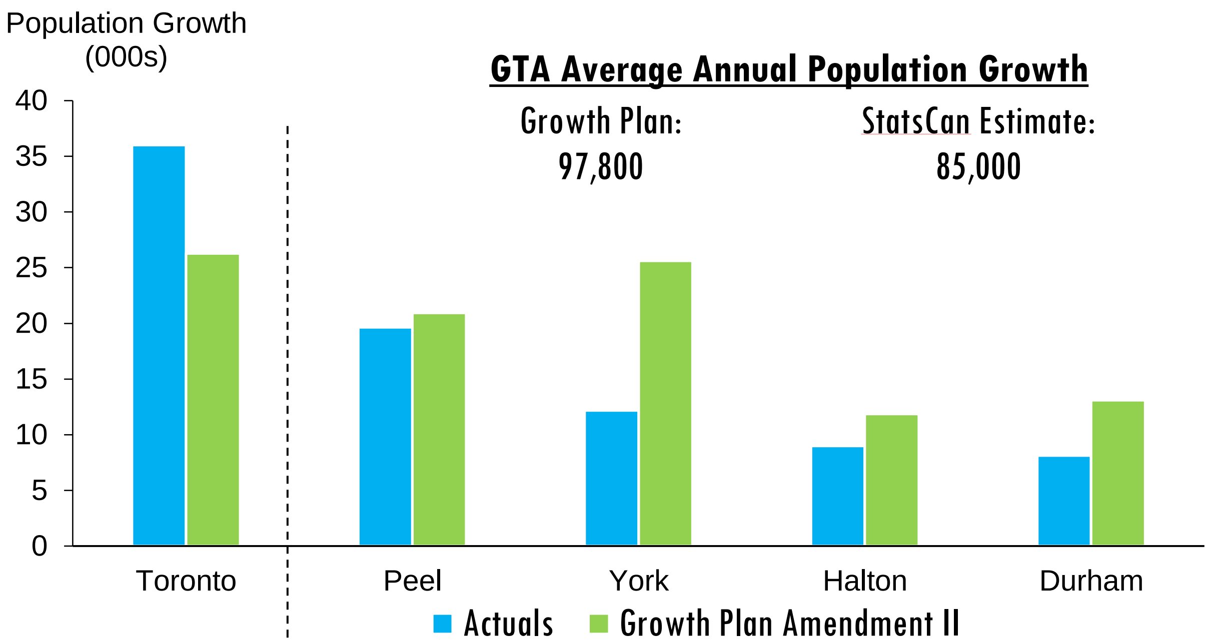
However, according to Statistics Canada population growth in York Region has been below the Growth Plan projections. While the Region grew rapidly in the early 2000s, the pace of growth has slowed. As shown in Figure 4, between mid-2011 and mid-2018, York Region grew by 12,200 people annually, or about half of the annual growth projected by the Growth Plan. Other 905 municipalities are also facing a shortfall, while Toronto's population growth exceeded Growth Plan projections.

Lower-than-expected growth has translated into lower-than-expected development charge collections. Should growth fall below what is currently assumed in the fiscal strategy, this may limit the Region's ability to finance new projects or repay existing debt, which may require a re-evaluation of the timing of planned projects in the capital plan.

A detailed discussion on the long-term development charges collections forecast for the Region can be found on pages 10 and 11 of the 2020 Long-Term Debt Management Plan attached to this report.

Figure 4

Actual vs Projected Population Growth in the GTA from (2011-2018)



Data Source: Growth Plan Amendment II technical addendum, Hemson Consulting Ltd., StatsCan Table: 17-10-0139-01

Second Element of the Fiscal Strategy – Reserve Management

Reserves are a very important element of the fiscal strategy. They fund capital asset spending and help to smooth tax levy and user rate requirements as well as provide financial flexibility in the event of unanticipated expenditures or a drop in revenue. In addition, because reserves consist of both cash and cash equivalent assets, they promote investor confidence and help to preserve the Region's credit ratings.

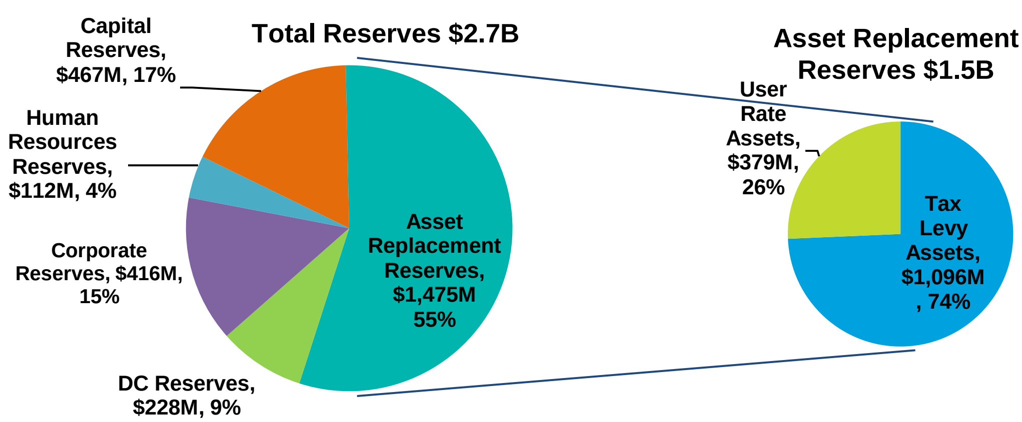
There are 59 reserves holding approximately $2.7 billion as of December 31, 2019. Most of these reserves will be used to fund future capital needs and are grouped into the five categories shown in Figure 5. The largest category, approximately $1.5 billion are for the Asset Replacement Reserves. At approximately $467 million, Capital Reserves represent the second largest category and include funding for capital programs such as social housing development, solid waste management and for contributions to hospital capital projects. The Corporate Reserves make up the third largest category, which includes the tax levy Debt Reduction Reserve and various stabilization reserves.

Development Charges reserves are the fourth largest, and are required to be held separately. On the Region's balance sheet these reserve funds are considered to be deferred revenue rather than a reserve, and are managed along with development charges debt to fund growth-related capital projects.

The figures and discussion above do not include the Sinking Fund Reserve, which is a segregated fund that can only be used to repay existing debt. The amount in this reserve is netted against the total outstanding debt to arrive at the "net" outstanding debt shown elsewhere in this report. The reserve consists solely of the cumulative amount of principal repayments that have been made each year for the retirement of existing debt as well as the interest earned on the balance. As of December 31, 2019, the balance in the Sinking Fund Reserve will be approximately $699 million.

Figure 5

Composition of Reserves Estimated as at December 31, 2019



Source: York Region Finance Department

Asset replacement reserves continue to grow

Figure 6 shows the overall reserve balance for asset management is expected to increase from $1.5 billion in 2019, to nearly $3.6 billion by 2029.

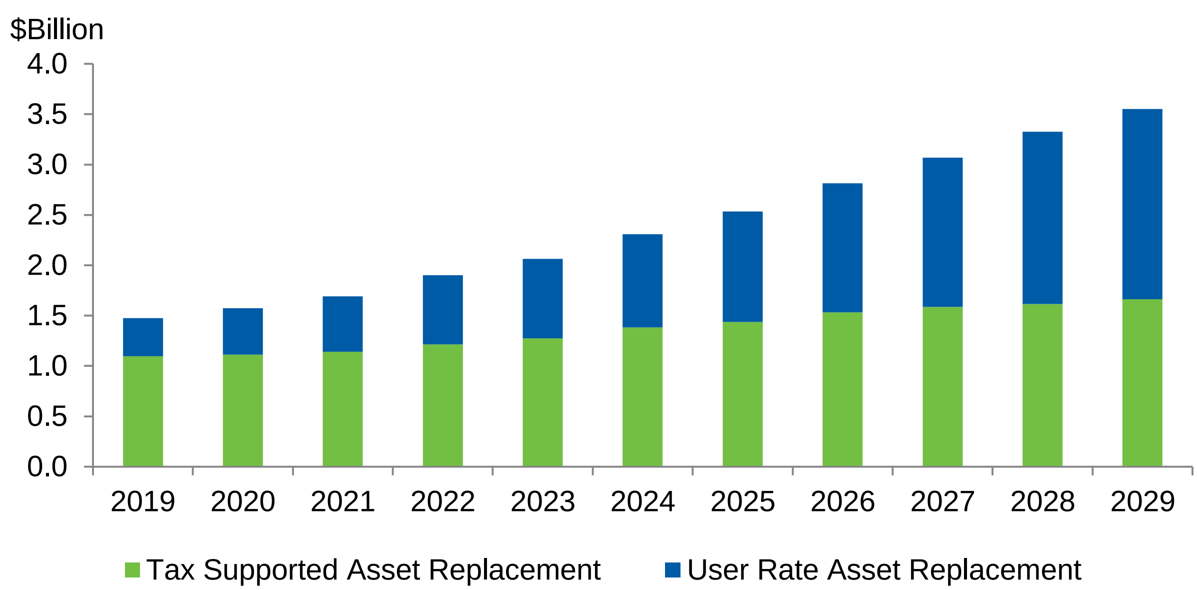
Starting with the 2019 budget, the annual contribution to replacement reserves has been calculated using detailed data from the departmental asset management planning process, which is a more accurate reflection of the corporation's long term needs.

For water and wastewater, Council has approved six years of rate increases to achieve full cost recovery for water and waste water rehabilitation by 2021. Contributions were determined based on the 2015 User Rate Study and are updated annually. These contributions have been reflected in the rates for the past several years.

To meet future asset management needs, without issuing additional tax-levy or user-rate supported debt, reserves will still need to grow significantly. The majority of the Region's capital assets were built within the last 20 years. Their estimated replacement value currently stands at over $14 billion, and the 2020 10-year capital plan includes approximately $4.0 billion of additional growth-related projects. Eventually, this infrastructure will need to be replaced and the $1.5 billion currently set aside in the asset management reserves will need to continue to grow significantly.

Figure 6

Capital Asset Replacement Reserve Balances (2019-2029)



Source: York Region Finance Department

The Debt Reduction Reserve avoids the need for future tax levy debt

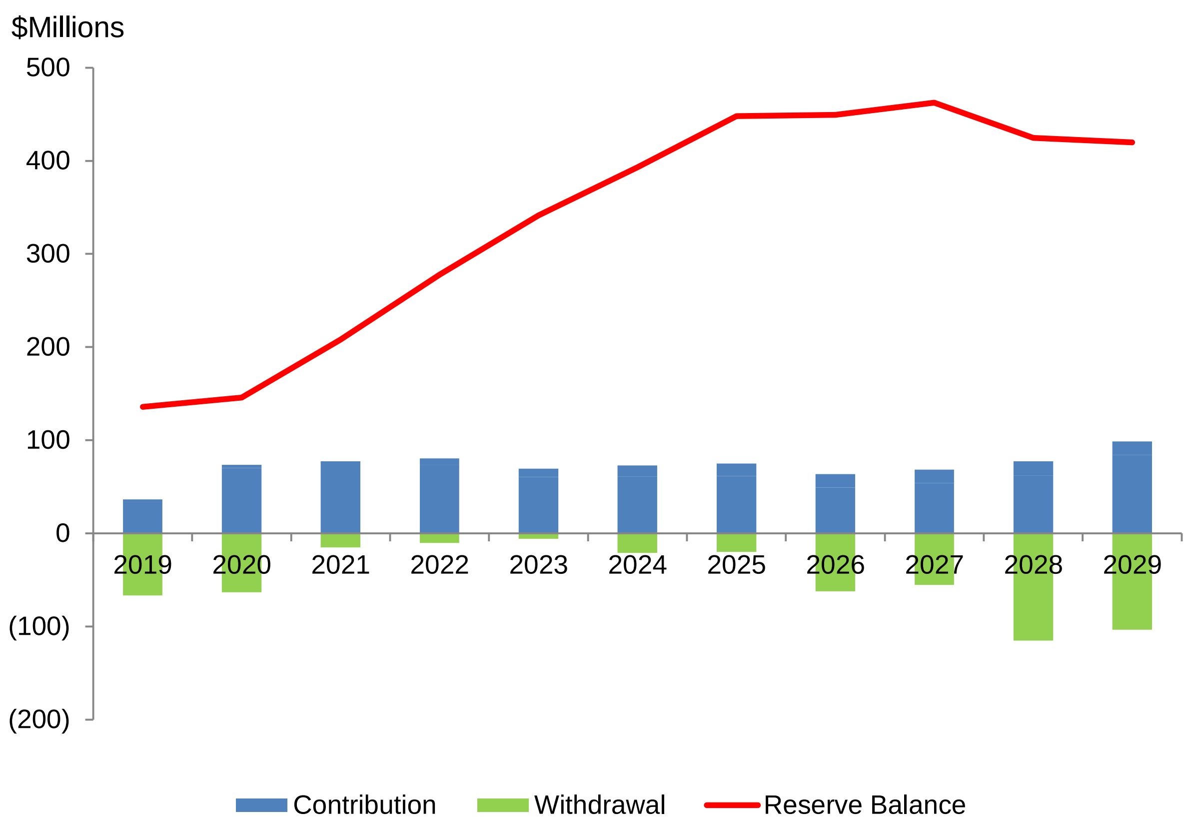
The Region is required to use tax levy funding for non-eligible capital and/or asset enhancement of growth-related infrastructure. Funding for this comes from several different reserves, the most important of which is the tax levy funded Debt Reduction Reserve.

Since its inception in 2014, this reserve has funded over $375 million of capital investments. Over the next ten years it is expected to fund an additional $436 million of investments and could also help fund projects that are not currently reflected in the capital budget.

Figure 7 shows the forecasted activity and the overall balance of the tax levy funded Debt Reduction Reserve.

Figure 7

Debt Reduction Reserve Activity (2019 – 2029)



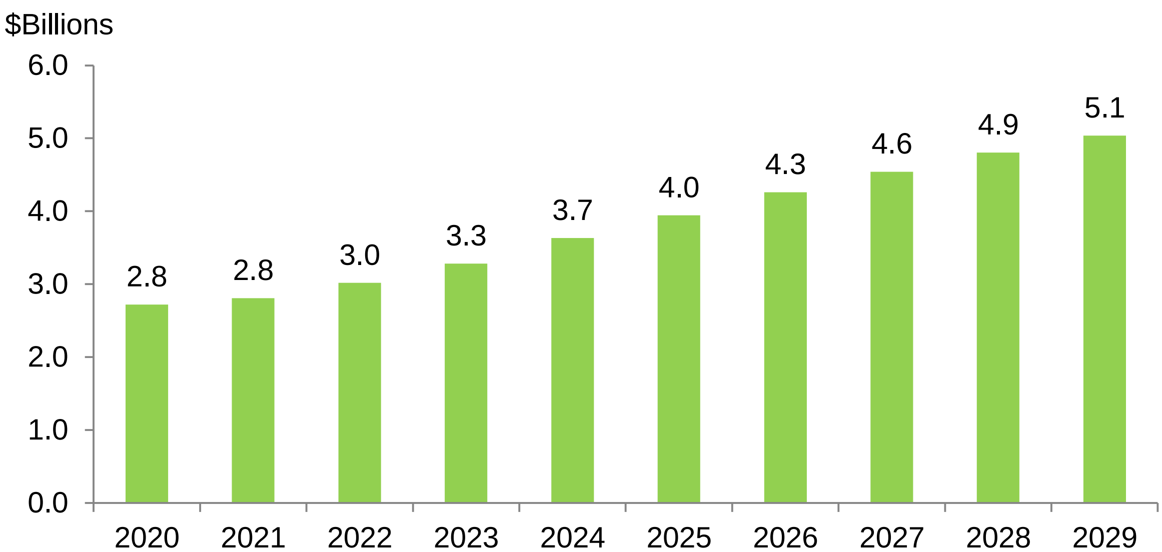
Source: York Region Finance Department

Total reserves are expected to grow moderately and reach $5.1 billion by 2029

Figure 8 shows that total reserves could grow to approximately $5.1 billion by 2029. Of this amount, around $3.6 billion would be for asset replacement that will be used to replace the Region's assets without having to issue any tax levy or user rate debt. The contributions to the Debt Reduction Reserve that were discussed previously are the other main contributor to the increase.

Figure 8

Total Reserves (2020 – 2029)



Source: York Region Finance Department

Third Element of Fiscal Strategy – Debt Management

Debt is a financing tool that permits the Region to provide necessary infrastructure to support growth in advance of growth occurring. Debt is not a funding tool; rather it is repaid over time by an identified source, which, for the Region is primarily development charges. While debt is an important tool, it also carries risk. If the funding source is insufficient in any year, there could be a shortfall that needs to be covered by other sources. There is a fine balance between financing the necessary capital for growth, and not building infrastructure too far ahead of when growth occurs.

Keeping borrowing needs as low as possible is a way to manage the risk that growth may be slower than expected, since the Region is required to service its debt whether or not development charges are collected. It also preserves fiscal flexibility by ensuring the Region has good access to the financial capital markets and is able to keep interest costs down relative to own-source revenue.

A further discussion on the risks associated with debt, as well as the mitigation strategies used by the Region, is discussed in Section 3 of the 2020 Long-Term Debt Management Plan attached to this report.

92% of the Region's outstanding debt is for growth-related infrastructure

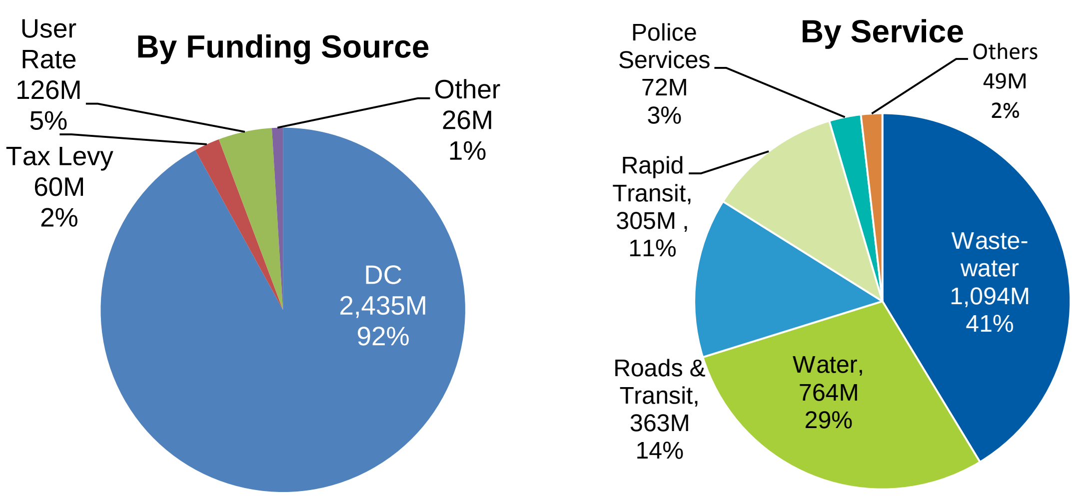
Approximately 92 per cent of the outstanding debt at the end of 2019 is growth-related and will be funded through future development charge collections, as shown in Figure 9 below.

As a result of the establishment of the Debt Reduction Reserve and the funding of the Asset Replacement reserves, no new additional tax levy or user-rate supported debt is planned over the next 10 years.

Figure 9

Outstanding Net Debt – York Region as at December 31, 2019

$2.6 Billion



Note: Outstanding debt is an estimate and subject to change as part of year-end adjustments.
Source: York Region Finance Department

Projected debt levels are related to future growth

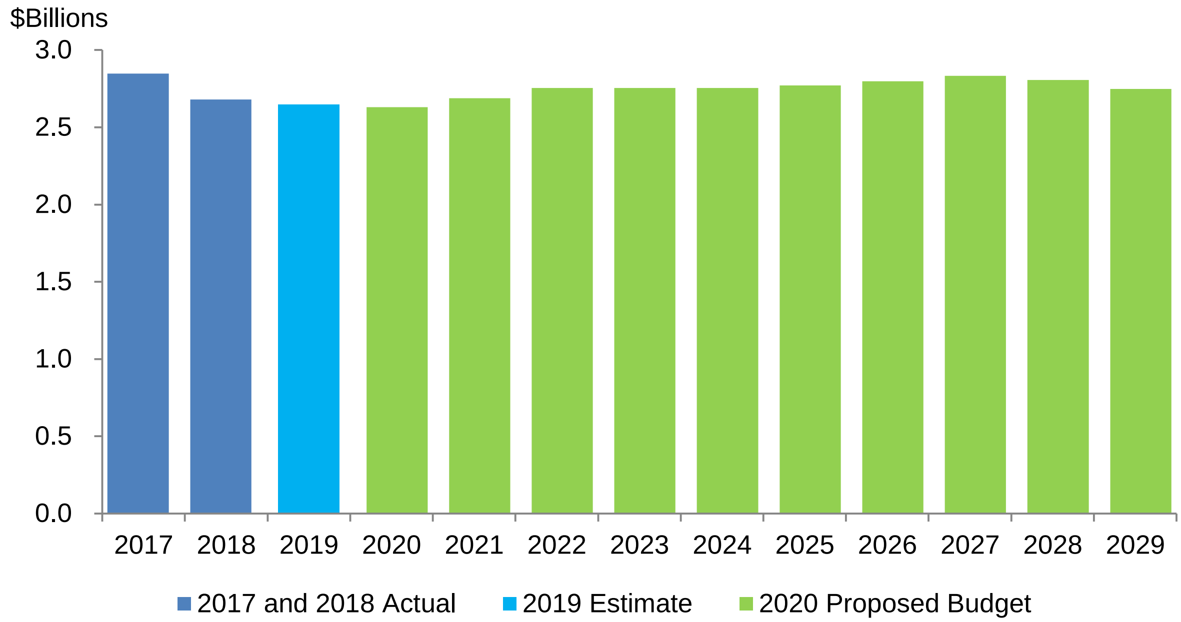
The 10-year Capital Plan projects approximately $4.0 billion for new growth-related infrastructure, for which approximately $2.5 billion in new debt will be required. Also during the ten years from 2020-2029, the Region will be required to pay approximately $3.5 billion in principal and interest for its existing and future debt.

The projected outflows for principal, interest and funding for new capital combined with the latest development charges collection forecast produce the debt profile shown in Figure 10.

Prior to the 2014 fiscal strategy, the peak outstanding debt was forecasted to reach over $5.0 billion by 2020. However, as a result of the measures taken over the last six budget cycles, the total net outstanding debt peaked at $2.9 billion in 2017, and is expected to remain below this level during the forecast period.

Figure 10

Outstanding Net Debt Projection by Year



Source: York Region Finance Department

Lower short-term growth and Bill 108 will impact the Development Charges collections

As a result of the lower collections anticipated from slower growth over the near term and impact of Bill 108, the Development Charges reserves are expected to be lower than previously forecast over the next ten years. A more detailed discussion on the impact of Bill 108 can be found on page 9 of the 2020 Long-Term Debt Management Plan attached to this report.

The current forecast anticipates that the reserve balance could fall below the Region's approved policy level of 75% of one year planned principal and interest payments starting in 2022 and will fall below zero by 2029. The reserve balance is then expected to recover with the balance climbing above one year principal and interest level by the middle 2030's. This recovery assumes that the 2041 population target in the Growth Plan will be met, resulting in higher forecasted development charges collections starting from 2032.

The Region will need to refinance a portion of its debt in 2020

In 2010, York Region issued $200 million of 10-year debentures at an interest rate of 4.50 per cent per year. However, some of the projects had a debt amortization period of twenty years. Similar to a mortgage, the amount owing for these projects when the debenture matures in 2020 will be $122 million which has to either be refinanced or fully repaid in 2020.

Figure 11 details the funding breakdown of the amounts that need to be refinanced or repaid.

Figure 11

2020 Refinancing Requirements

Funding Source		Refinancing Required ($Millions)
Development Charges		106.7
Tax Levy		9.6
User Rate		
Water	3.1	
Wastewater	2.6	
		5.7
Total		122.0

Source: York Region Finance Department

In accordance with previous Council direction, the 2020 Budget proposes to refinance only the $106.7 million of development charge funded debt and internally borrow the remaining tax levy portion from the Debt Reduction Reserve ($9,585,955) and the user rate portion from the Capital Asset Replacement Reserve - Water ($3,094,195) and the Capital Asset Replacement Reserve - Wastewater ($2,601,626).

This strategy would allow the Region to reduce its external net debt by a further $15,281,775. This repayment is currently reflected in the debt forecasts presented in this report. It would also result in an annual reduction in principal and interest payments of $2,020,717. The annual savings would be used to repay the three reserves as detailed in Figure 12.

Figure 12

Annual Debt Savings Redirected to Reserves

Reserve	Amount ($)
Debt Reduction Reserve	1,267,556
Capital Asset Replacement – Water	409,147
Capital Asset Replacement – Wastewater	344,014
Total	2,020,717

Source: York Region Finance Department

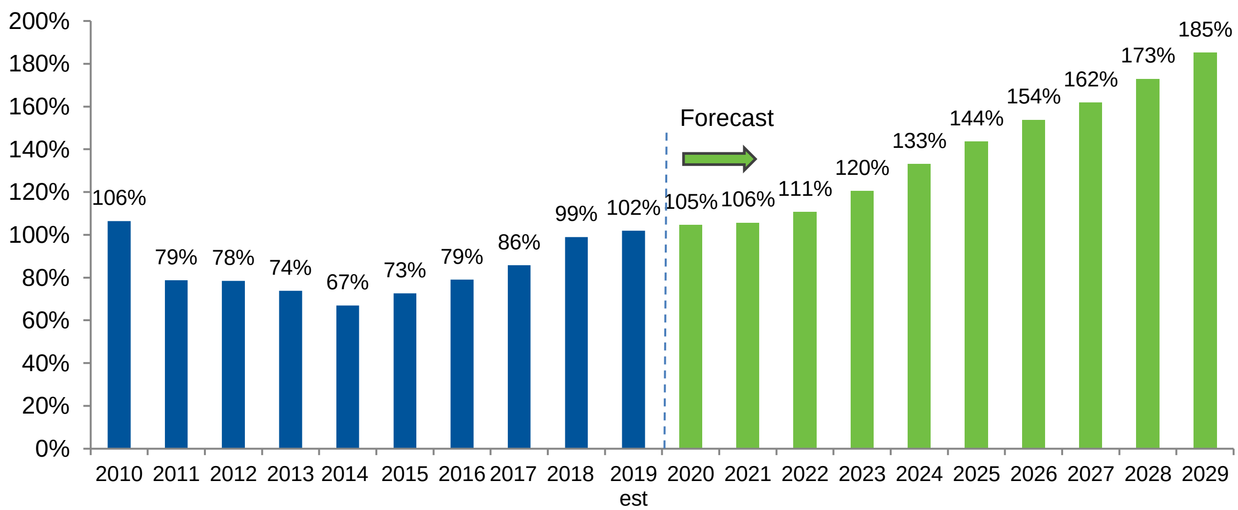
These three contributions would be made annually for 10 years, which matches the principal and interest saved through paying down debt.

York Region became a net investor in 2019

The Region is expected to be a net investor in 2019, one year ahead of the forecast presented in the 2019 Fiscal Strategy. A ratio greater than 100 per cent indicates the Region is a net "investor" as opposed to a net "borrower". The improvement to this forecast is as a result of delays in reserve draws. The current forecast is shown in Figure 13.

Figure 13

Reserves to Debt Ratios



Source: York Region Finance Department

YORK REGION CREDIT RATING

The Region's credit ratings (Moody's Aaa/Stable and S&P AA+/Positive) remain strong

In 2019, Moody's Investors Service (Moody's) reaffirmed their credit rating for York Region and S&P Global Ratings (S&P) upgraded York Region's outlook from Stable to Positive, supported by:

- A high level of cash and investments
- Prudent and far-sighted fiscal management
- A track record of positive operating outcomes
- Its diversified and expanding economy
- Considerable budgetary flexibility

The positive outlook from S&P reflects the possibility that within the next two years, S&P could raise the rating to AAA should economic growth support a larger assessment base and that a high level of development charge revenue is available to support York's capital program.

Moody's and S&P highlighted York's exceptional liquidity profile but remain concerned with the Region's high level of debt

Both rating agencies have expressed concern about the Region's high debt burden, especially relative to other rated Canadian municipalities. In particular, Moody's and S&P identified three factors that could lead to a future downgrade:

- a sustained increase in the debt burden
- a material decline in liquidity
- if management's commitment to fiscal sustainability weakened in the face of slower economic growth

2020 LONG-TERM DEBT MANAGEMENT PLAN

The 2020 Long-Term Debt Management Plan needs to be adopted to access the growth-related borrowing capacity

The Annual Repayment Limit (ARL) regulation under the Municipal Act, 2001, limits the amount of municipal debt and other financial obligations that a municipality can assume.

In 2011, the Province recognized that York Region is a high growth municipality with unique debt requirements and provided a York-specific regulation that allows it to borrow a higher amount based on its development charges collections. In 2013 and 2014, the Region would have breached the annual repayment limit in the absence of the growth-related cost supplement.

To qualify for this additional growth-related borrowing capacity, Council is required to adopt or affirm a plan for the management of its long-term debt and financial obligations on an annual basis. This plan is provided as Attachment 1 to this report.

The Region's growth-related cost supplement regulation will expire in 2021

A more fulsome discussion on the growth-cost supplement can be found on page 2 of the 2020 Long-Term Debt Management Plan attached to this report.

This regulation will expire on December 31, 2021. Staff intend to begin discussions with the Province to explore the renewal or replacement of this regulation. This would give the Region more flexibility to finance major growth-related infrastructure projects, such as the Yonge Subway Extension, should it be needed.

5. Financial

Since the implementation of the fiscal strategy in 2014, Council has taken significant steps towards achieving financial sustainability. Based on a continued commitment to the approved budget outlook and the fiscal strategy, the Region would be able to maintain high levels of liquidity, save adequate reserves for future asset management needs, and reduce outstanding debt.

6. Local Impact

Local municipalities will benefit from the fiscal strategy as it supports the Region's credit rating. Since local municipalities must issue all debenture debt and repay debt financing costs through the Region, a good credit rating helps to ensure that both the Region and local municipalities obtain the lowest possible cost of financing.

7. Conclusion

The fiscal strategy has resulted in careful management of the capital plan, an increase in reserves and reduced reliance on debt, all intended to help the Region achieve financial sustainability.

The fiscal strategy is updated annually and evolves as economic circumstances change and as more rigorous analysis is developed.

For more information on this report, please contact Edward Hankins, Director, Treasury Office and Deputy Treasurer at 1-877-464-9675 ext. 71644. Accessible formats or communication supports are available upon request.

Recommended by: **Laura Mirabella, FCPA, FCA**
Commissioner of Finance and Regional Treasurer

Approved for Submission: **Bruce Macgregor**
Chief Administrative Officer

December 3, 2019
Attachment 1
Edocs# 10168358