Winnipeg

CITY OF WINNIPEG POLICY NO. FI-016

POLICY TITLE *Debt Strategy*	ADOPTED BY *City Council*	EFFECTIVE DATE *February 22, 2024*
ORIGIN / AUTHORITY *Executive Policy Committee*	**CITY POLICY NO.** *FI-016*	**MOST RECENT CONSOLIDATION**

1. Purpose

Determine a Debt Strategy and set debt limits to establish a prudent level of debt to support the City's capital infrastructure program while maintaining an appropriate credit rating, long-term financial flexibility and sustainability.

2. Definitions

2.1 **"Loan Guarantee"** A loan guarantee is a promise that the City will repay a lender (e.g., a bank or other financial institution providing credit or funding to another party) the amount guaranteed, subject to the terms and conditions of an agreement and subject to the existing Council adopted Loan Guarantee Policy, which aligns with the City of Winnipeg Charter sections 219 to 220. If the borrower defaults, the City is responsible for payment of the balances outstanding on the loan. The guarantee will reduce the lender's risk and should enable the borrower to secure a loan at a lower interest rate or obtain a loan that might not otherwise have been achievable.

2.2 **"Public-Private Partnership"** Public-Private Partnerships involve collaboration between a government agency and a private-sector company that can be used to finance, design, build, maintain and operate projects, (or a combination of such actions) including public transportation networks, roadways and bridges, or other significant projects. Financing a project through a public-private partnership may facilitate capital project delivery, budget goals and associated feasibility.

2.3 **"Sinking Fund Debentures"** Sinking Fund Debentures, or bullet bonds, are debt instruments where a single payment is due on the maturity date of the debenture. Interest payments occur during the term of the debt. Annual principal contributions are also made to a Sinking Fund. These contributions will earn interest, with the goal of funding the principal repayment upon maturity of the debenture.

3. Debt Strategy

3.1. Alignment with Management Policy

The Debt Strategy is distinct from the City's Debt Management Policy. The City's Debt Management Policy sets forth the parameters for issuing debt and managing outstanding debt and provides guidance to decision makers regarding the timing and purposes for which debt may be issued and the types of debt and structural features that may be incorporated. It does not set out a specific debt strategy or outline debt limits.

3.2. Leading Practices

Leading practices incorporate the following concepts:

- Debt Capacity: the ability to sustain debt service costs over the long term.
- Affordability: the ability to pay debt service costs as well as life-cycle costs to maintain the asset.
- Flexibility: the ability to respond, in the short term, to emerging capital needs.

Debt Capacity is the ability to service debt over the long term and revenue growth has been used as an indicator to determine a municipality's ability to service debt. The City's major revenue source is property taxes which equates to thirty-four (34%) percent of the 2023 operating budget.

Affordability is not a measure of the total debt outstanding. It is a measure of both the City's and the citizens' ability to pay for debt.

There are two basic financial models to determine affordability of debt – an expenditure-based model and a revenue-based model.

(1) *Expenditure-based Model –* An expenditure-based measure of affordability limits annual debt service costs (interest and principal payments) to a specific dollar limit or to a specified percentage of expenditure. Limiting debt service to a certain dollar amount may not be an effective methodology as inflation will cause a decline in purchasing power and less and less capital work will be undertaken over time. A model based on a percentage of expenditure can overestimate the City's debt service capacity because as the City spends more, then the model will assume it can afford more debt and spending is not an indication of ability to pay.

(2) *Revenue-based Model –* A revenue-based measure of affordability is debt service as a percent of revenue. This links the source of funding to the requirement to service debt and implies sustainability of debt service costs. Debt service as a percent of revenue implies that, as revenue grows, debt service can grow proportionately. This assumes that growth in other expenditures is not outpacing growth in debt service costs. This methodology would indicate that if revenue is growing, new debt issues may be an ongoing part of the capital plan.

A revenue-based model will continue to be used and is consistent with prior Debt Strategy Policies.

Financial flexibility is the financial capacity reserved for emerging capital needs. This reserved capacity would provide a contingency for replacement, construction or purchase of an asset to ensure a partnership or investment opportunity is not missed, to ensure the safety of an asset, to take advantage of new technology, to address capital compliance costs with respect to emerging legislation, to address extraordinary price increases/capital construction inflation, or to approve any project of importance not previously considered in the capital plan. This flexibility could also be used to finance an urgent capital project in the event the market was not receptive to municipal debenture issues, which could occur during economic downturns. The amount of financial flexibility that should be maintained is subjective and may vary depending on the volatility of other revenue and expenditures, and existing provisions for contingency and risk in the organization.

The City's short-term investment portfolio and reserve funds may provide flexibility for emerging capital needs.

The Government Finance Officers' Association of the United States and Canada recommends that governments should define specific debt limits or acceptable ranges for debt. Public policy limits can include the purposes for which debt proceeds may be used or prohibited. Appropriate debt limits can positively impact bond ratings if the government demonstrates adherence to such policies over time.

3.3 When may Debt Issuance be Advisable?

Depending on the interest rate environment, debt issuance may be advisable where a capital project is:

- intergenerational in nature (i.e. a large project with long-term benefits);
- benefiting the community at large;
- growth related;
- a major rehabilitation; and/or
- financed by a dedicated revenue stream.

Low interest rate environments may create a very favourable environment to issue debt. However, issuance of debt must consider growth in the City's revenues and remain affordable to the Citizens of Winnipeg.

3.4 Debt Financing of Capital Assets

While it is true that the use of debt increases the overall cost of assets due to interest costs, this is a limited view of capital financing. It does not consider the opportunity cost of delaying the project due to construction cost escalation or general inflation in the case of non-construction capital projects, nor does it consider interest rate risk due to changing borrowing costs if borrowing occurs at a later date. Debt financing also provides a mechanism to spread costs over the life of the asset as well as distribute costs over generations.

Inflation is one element to consider; however, affordability is the over-riding concern and must be balanced in moderation with reference to the upper debt-limit maximums to achieve financial flexibility

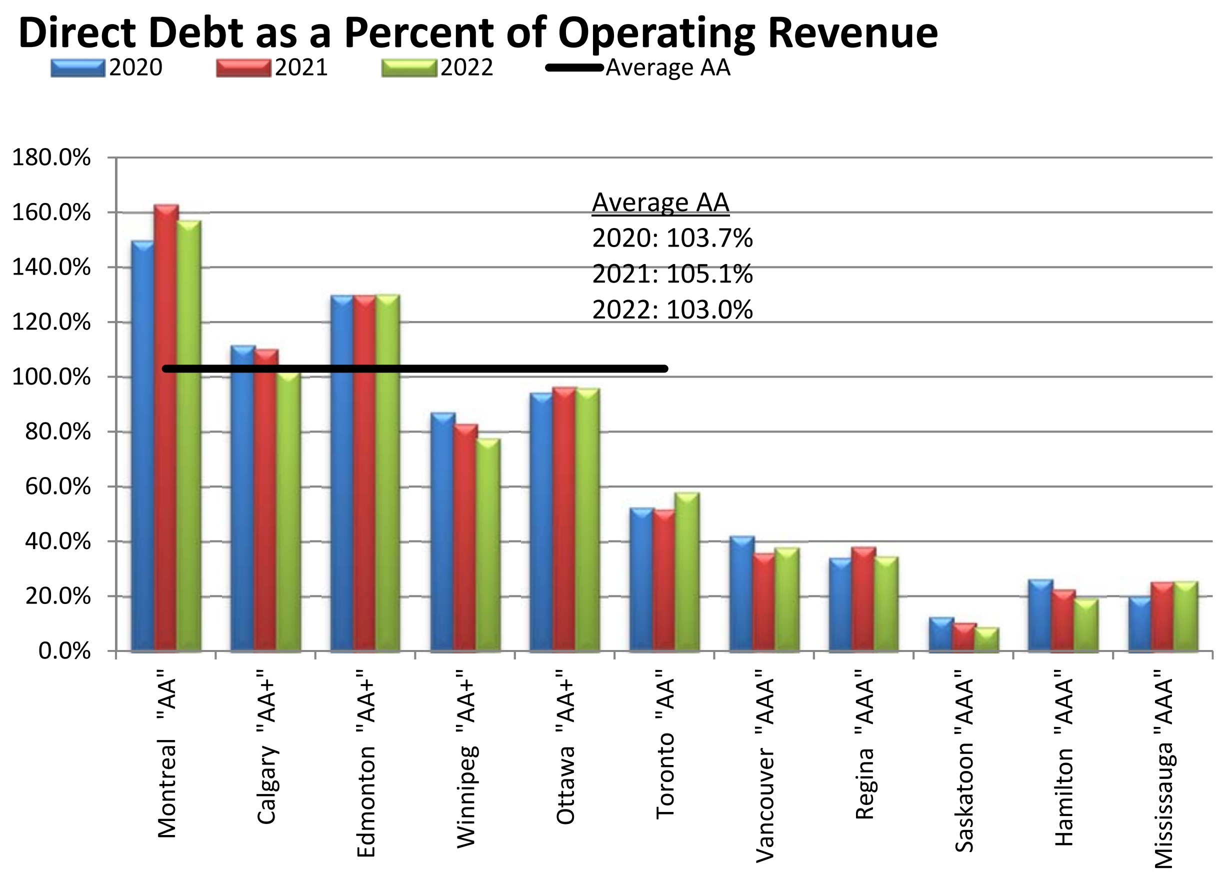
4.0 Comparative Information with other Municipalities

Credit rating comparison: Credit rating agencies use past financial performance and management practices to predict trends for future performance. The following is a list of recent credit ratings from Standard & Poor's for Winnipeg and other Canadian cities as well as their respective province's ratings. Credit ratings of the provinces have been disclosed as there is a very high likelihood of provincial support (as regulators of municipalities) to prevent reputational damage in the event of municipal default. The provincial credit rating is a factor in determining the credit rating of a municipality.

	Municipal Credit Rating	Provincial Credit Rating
Winnipeg	AA+	A+
Calgary	AA+	A+
Edmonton	AA+	A+
Hamilton	AAA	A+
Montreal	AA	AA-
Mississauga	AAA	A+
Ottawa	AA+	A+
Regina	AAA	AAA
Saskatoon	AAA	AAA
Toronto	AA	A+
Vancouver	AAA	AA

4.1 Key Comparable Municipal indicators:

Following are a series of graphs that compare key indicators that influence credit ratings for selected Canadian cities as rated by Standard and Poor's for 2022. This is the most recent comparative information available from Standard and Poor's.
Direct Debt[1] as a Percent of Operating Revenues[2]: Of the following Canadian municipalities rated by Standard & Poor's in the AA to AA+ category, the average direct debt as a percent of operating revenues was 103.0% in 2022. Winnipeg's direct debt as a percent of operating revenues in 2022 was below average when compared to these other Canadian municipalities.

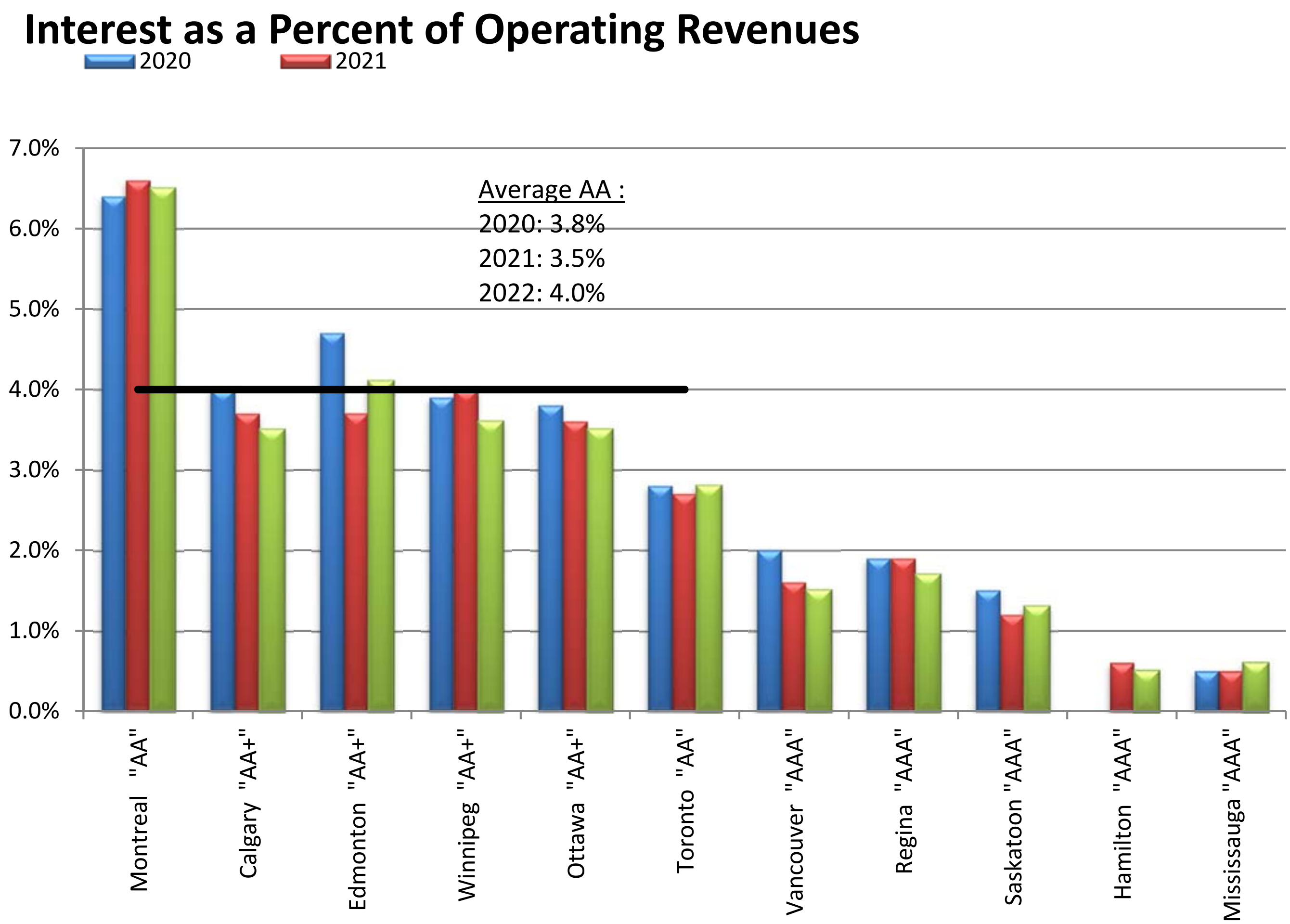


*Source: Standard & Poor's, Ratings Direct

[1] Definition of Direct Debt: Long-and short-term financial debt assumed directly by the borrower (loans, bonds, credits, and capitalized lease obligations) that a local and regional government (LRG) is obliged to pay to another entity in accordance with an express agreement or for any other legally binding reason. This excludes guaranteed debt and the debt of government-related entities, unless serviced by the LRG on an ongoing basis. It includes debt serviced via subsidies from other levels of government unless the legal obligation to service this debt is transferred to the other government. Standard & Poor's

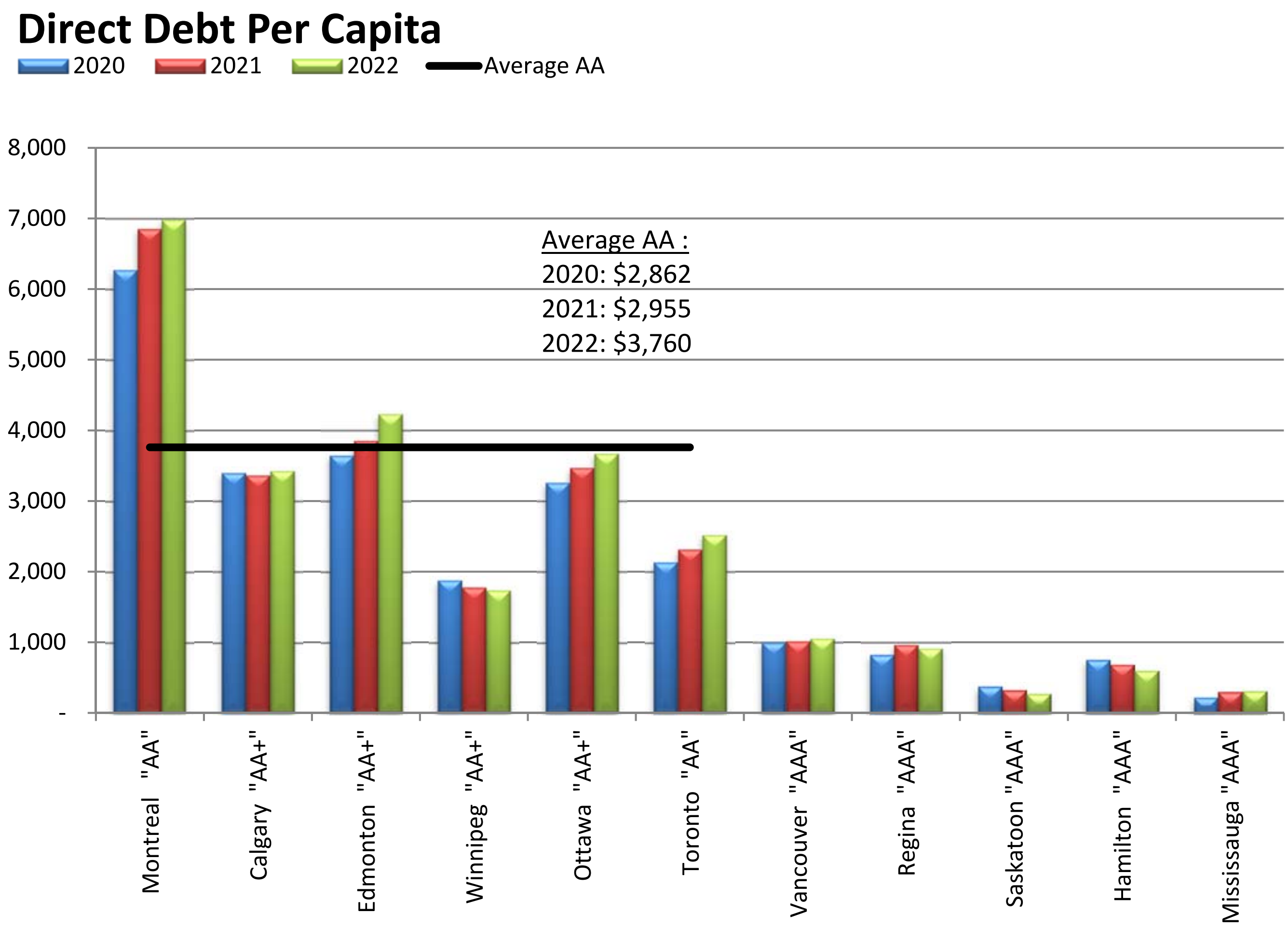
[2] Definition of Operating Revenues: Recurrent revenues received by an LRG. Operating revenues are comprised of taxes and non-tax revenues such as grants, operating subsidies, fines, and fees for services, tariffs, rents, and other sources levied by the LRG. They exclude capital revenues such as capital subsidies and sales of assets, and any revenues from borrowed funds. Standard & Poor's

Interest[3] as a Percent of Operating Revenues: Of the following Canadian municipalities rated by Standard & Poor's in the AA to AA+ category, the average interest cost as a percent of operating revenues was 4.0% in 2022. Winnipeg's interest expenses were slightly below at 3.6% of revenue in
2022.



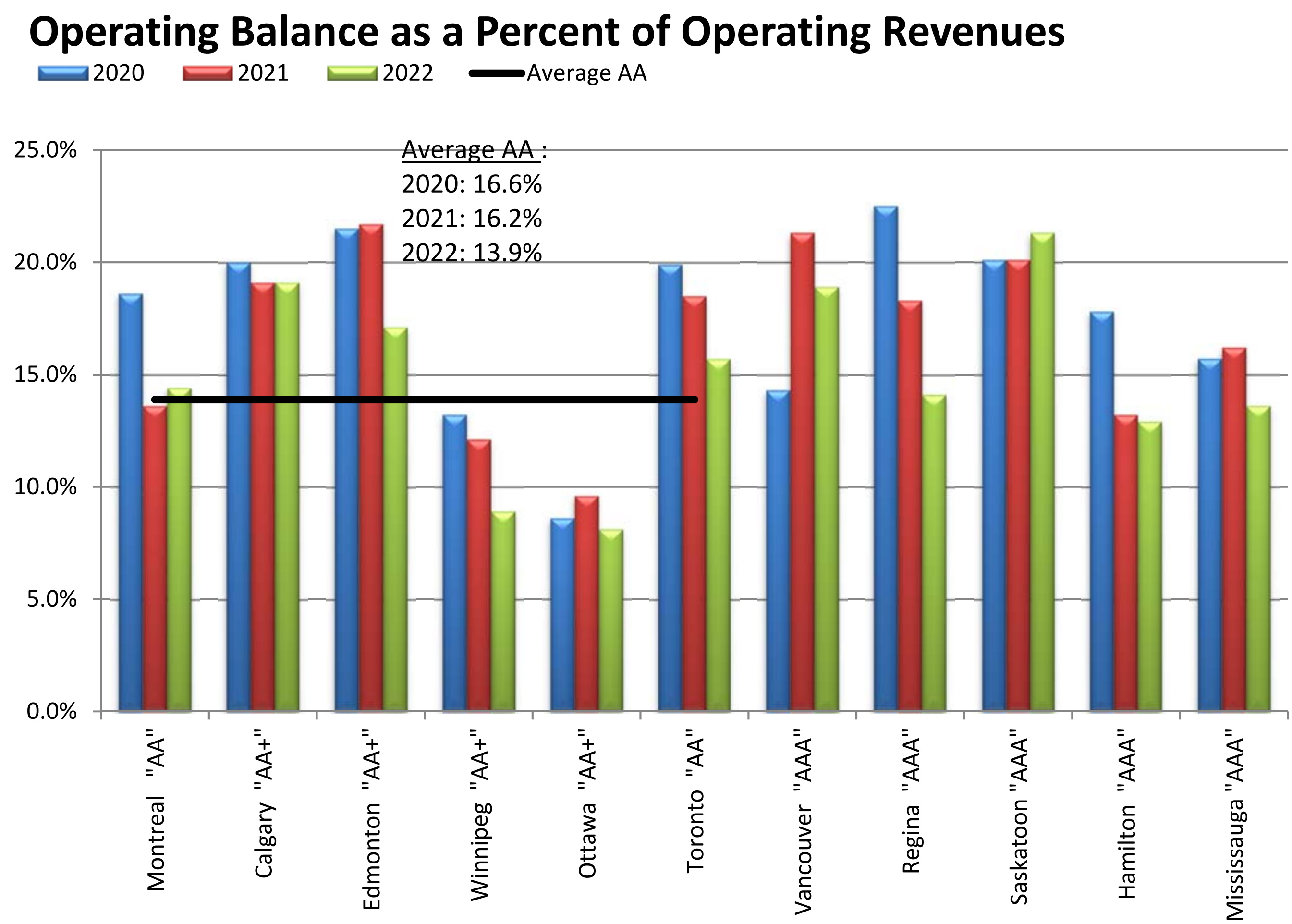
*Source: Standard & Poor's, Ratings Direct

Direct Debt Per Capita: Of the following Canadian municipalities rated by Standard & Poor's in the AA to AA+ category, the average debt per capita in 2022 was $3,760. Winnipeg was below this average at $1,735.



*Source: Standard & Poor's, Ratings Direct

Operating Balance[4] as a Percent of Operating Revenues: Of the following Canadian municipalities rated by Standard & Poor's in the AA to AA+ category, the average operating balance as a percent of operating revenues was 13.9% in 2022, which is a measurement of operating performance. Winnipeg had a lower than average operating balance as a percent of operating revenues in 2022 when compared to these other Canadian municipalities. Winnipeg's operating balance as a percent of operating revenues decreased from 12.1% in 2021 to 8.9% in 2022.



*Source: Standard & Poor's, Ratings Direct

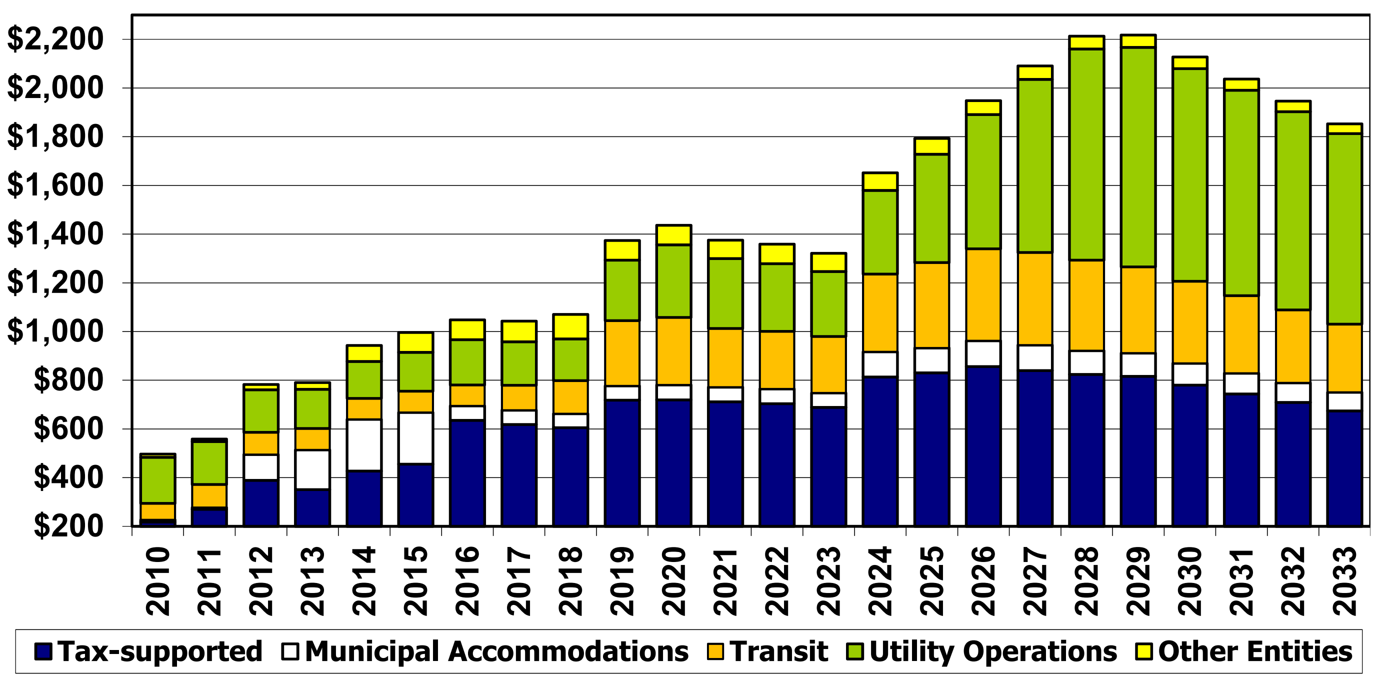
[4] Definition of Operating Balance: The difference between operating revenues and operating expenditures; measures an entity's ability to finance investments from recurrent revenues. Standard & Poor's

Winnipeg – Debt Metrics

The City has several loan guarantees with external organizations that would become the City's responsibility if the external organization defaulted on the loan. As at December 31, 2022, the amount of these outstanding loans totaled $77 million. There has never been a default by an organization and, therefore, loan guarantees have not been included in the debt metrics in this report nor are they included in the financial ratios or recommended limits.

However, forecasted net debt to 2033, includes NEWPCC, peaking in 2029 at just under $2.1 billion. New debenture debt has been forecasted over a 30-year period at an average interest rate of 5.5%. The recent low interest rate environment provided an opportunity to accelerate capital infrastructure rehabilitation and renewal. It should be noted that this forecast is an estimate at this time and forecasted amounts will change as these plans evolve and new initiatives are undertaken.

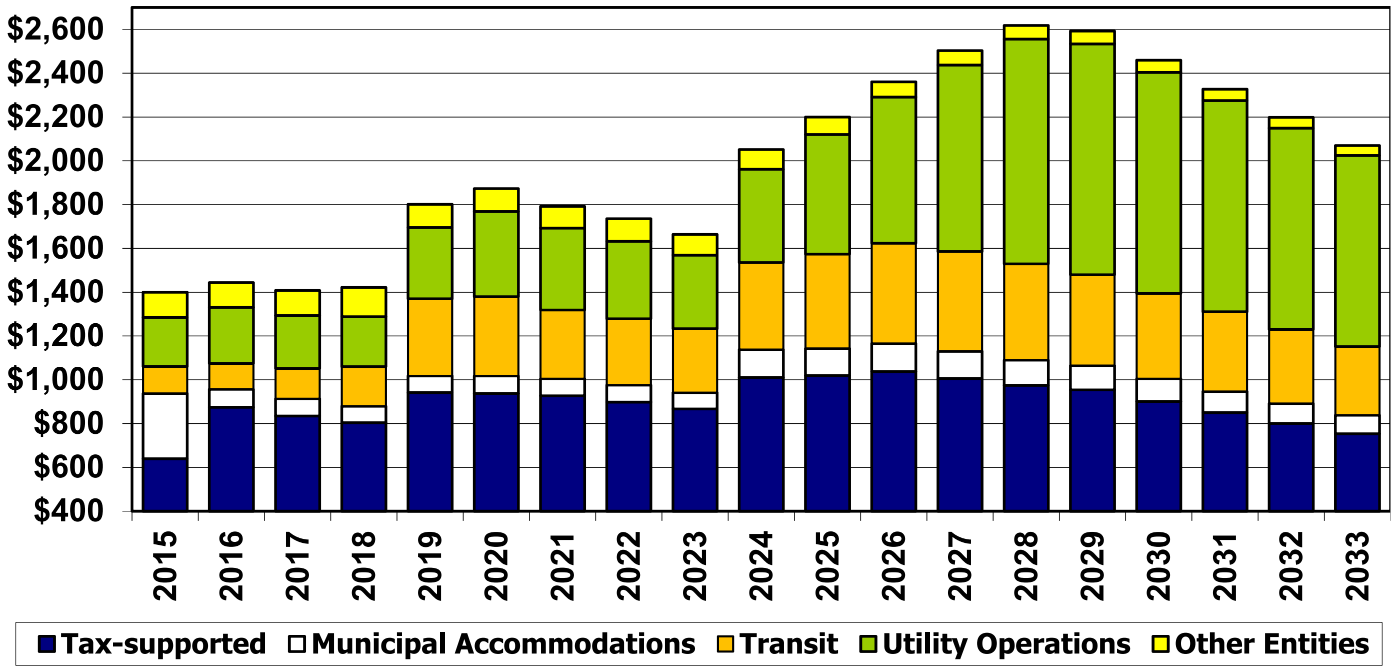
City of Winnipeg Net Debt
(in millions of dollars)



*Debenture debt and P3 obligations included.

Forecasted net debt per capita to 2033 is highlighted in the following graph and reflects the trend noted in the previous graph. At the high point in 2028, net debt per capita is anticipated to peak at $2,482.

City of Winnipeg Net Debt Per Capita



*Debenture debt and P3 obligations included.

A table outlining the forecasted net debt as a percent of operating revenue follows. Revenue from the tax supported 2023 projected operating budget has been used as a base with estimated revenue increases thereafter. Similarly, operating budgets and the 10-year rate plan have been used as a base for revenue estimates for utilities. Capital grants from other levels of government have also been factored in from the most recent budget information available with inflationary increases in the future.

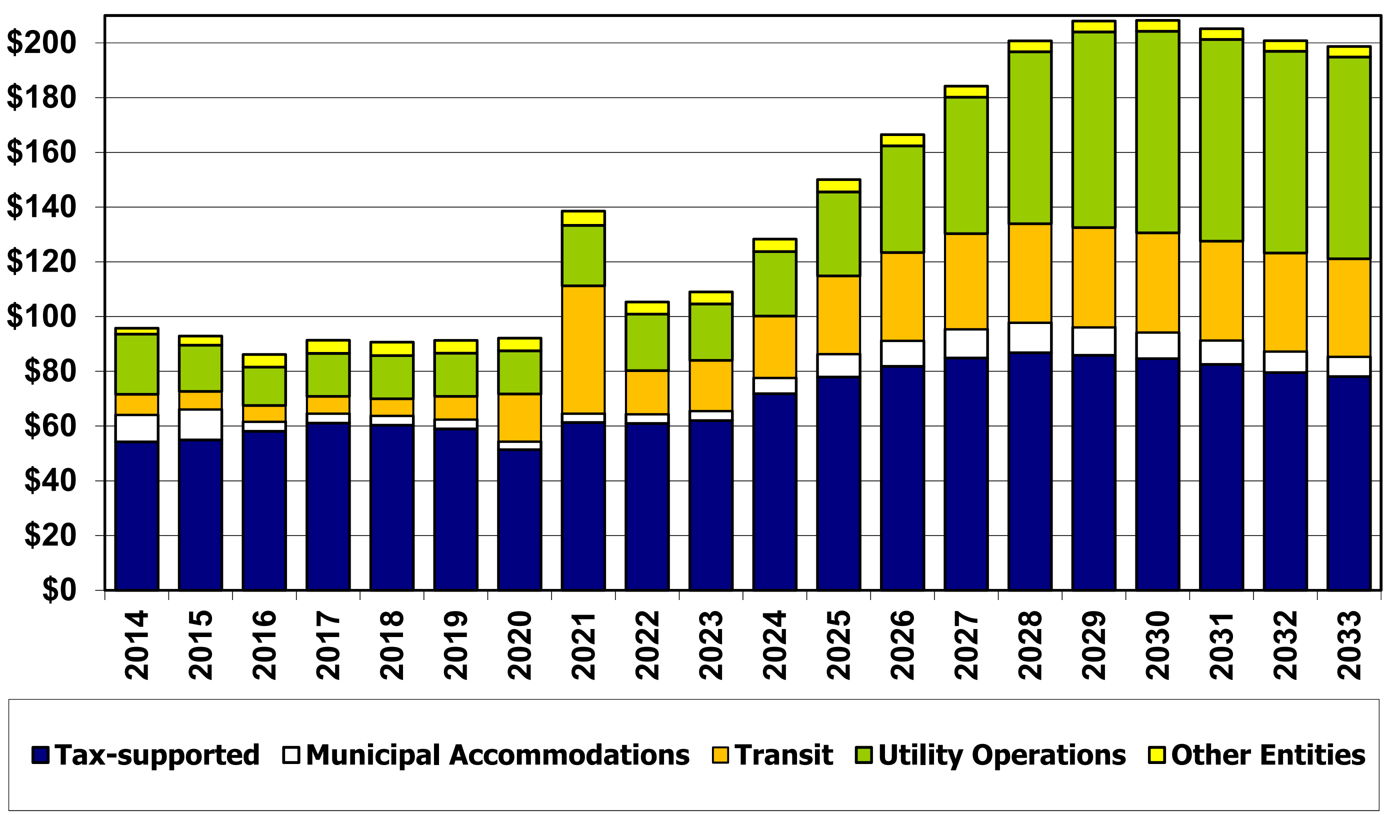
City of Winnipeg Forecasted Net Debt
as a Percent of Forecasted Revenue

	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Total City (includes other entities)	69.0	60.8	78.2	83.0	88.1	92.1	94.9	92.9	87.1	81.3	75.8	70.4

*Source: Debt Strategy 2024 – V1

The following graph outlines forecasted debt servicing payments.

City of Winnipeg Debt Servicing Costs
(in millions of dollars)



*Sinking Fund Debenture debt and P3 obligations included.

5.0 Summary

Credit rating agencies are supportive of long-range planning, as well as debt-limitation ratios as they result in a greater awareness of debt affordability. The Government Finance Officers' Association of the United States and Canada recommends that governments should define specific debt limits or acceptable ranges for debt.

Within the City's current revenue structure, forecasted net debt and debt servicing costs will be approaching the high level of what would be considered acceptable for a municipality with an AA credit rating in the next 5 years. The following table documents the debt limit for net debt as a percent of revenue as follows:

- Where we are now; that is, what was the ratio at December 31, 2022;
- What is the forecasted peak in this ratio in the next 10 years; and
- What limits are being recommended with respect to this financial ratio.

This proposed limit will provide a framework for future decision-making with respect to new debt authorizations.

Financial Ratios (Debt)	Where we are Now	Forecasted Peak	Recommended Limits
Measure of Sustainability: Net debt as a percent of revenue			
Total City, including other entities	69.0%	94.9%	100%

5.1 How does New Borrowing Impact the Debt Metrics?

A general guide to determining how new borrowing will impact the debt metrics

follows:

<u>For every $10 million in new debt</u>:

Net debt as a percent of revenue would increase by 0.47%

Annual debt servicing costs would increase by $678,000

Based on 30 year sinking fund debenture debt issuance at an interest rate of 5% and sinking fund contribution rate of 1.78%