Region of Peel
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REPORT
Meeting Date: 2023-07-06
Regional Council

REPORT TITLE:	**Ability to Finance the Servicing Shortfall of $11.1 Billion Related to the Local Housing Pledges**
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RECOMMENDATION

1. **That the Region of Peel not seek to incur long term debt in the amount of $11.1 billion to immediately finance the servicing shortfall associated with new provincial growth targets; and**

2. **That Regional Council continue to advocate to the Minister of Municipal Affairs and Housing requesting that the Province of Ontario create a municipal compensation fund to compensate the Region of Peel and its local municipalities in order that they be made whole as a result of the impacts of Bill 23 on municipal growth funding revenues and expenditures.**

REPORT HIGHLIGHTS

- The Region's practice has been to take on debt to build growth related infrastructure, which the Region relies on the future stream of Development Charges (DCs) to repay that debt.
- This bold approach has been taken to accelerate infrastructure delivery to ensure that housing could be built faster in support of growth and economic development, within one of the fastest growing areas in Canada.
- As at Dec. 31, 2022, Regional net debt outstanding was ~$1,270 million, of which $1,110 million is DC net debt.
- This report provides Council with information addressing the motion originally tabled at the June 22, 2023 Council meeting directing staff to issue $11.1 billion in debenture financing in fiscal year 2023 to meet the new provincial growth targets.
- Capital projects associated with the $11.1 billion have not yet been specifically identified and approved; work is underway to complete water and wastewater and transportation master plans necessary to coordinate and provide infrastructure to service the new growth.
- Annual debt service costs for $11.1 billion in financing are estimated at approximately $900 million, compared to the Region's current annual debt service costs of approximately $145 million.
- To remain within legislative and regulatory limits, projects for which debt is proposed to be issued must be first identified and approved by Regional Council and any borrowing must be within the prescribed regulatory limits.
- The *Municipal Act, 2001* and O. Reg. 403/02 provide for a process to exceed prescribed borrowing limits by seeking Ontario Land Tribunal (OLT) approval.
- Given the magnitude of the proposed debenture borrowing, if permitted by the OLT and issued, incurring the proposed debt would result in a materially significant deterioration of the Region's financial sustainability and flexibility.

DISCUSSION

Background

On February 23, 2023, staff provided a presentation to Regional Council titled "Infrastructure Planning and Request of the Province to Support Bill 23 Housing Targets." This presentation set out preliminary estimates for the infrastructure costs required to meet the Bill 23, More Homes Built Faster Act, 2022 provincial housing targets for Peel. Following the presentation, staff provided a report titled "Infrastructure Planning and Requests of the Province to Support Bill 23 Housing Targets" on March 9, 2023. This presentation and report estimated that, to achieve the new housing targets, the Region would be required to advance capital works beyond the current estimated 10-year capital plan, with an estimated cost of $8.9 billion, by an incremental amount of approximately $11.1 billion, thereby increasing the 10-year capital plan to approximately $20 billion for infrastructure works related to water, wastewater, and transportation. Staff recommended three (3) key tactics to support advancing infrastructure to support Bill 23 housing targets. As part of the 2024 Budget staff will be proposing key concepts to support tactic #3 which will include the advancement of key infrastructure to support key priority areas.

On June 22, 2023, a motion was tabled to Regional Council which was referred to staff and reads:

Whereas any delays in the construction of servicing capacity will block the ability to meet Bill 23 Housing Targets;

Now therefore be it resolved:

1. *That the Region of Peel commit to the immediate financing of the servicing shortfall of $11.1B to meet the new provincial growth targets adopted by all three local municipalities, as identified in the February 23, 2023 staff presentation to Regional Council on Infrastructure Planning to Support Bill 23 Housing Targets; and*

2. *That the required debenture be issued in the 2023 fiscal year to ensure the continuity of regional services as per the principles of the dissolution of Peel Region, adopted unanimously by Regional Council on June 8, 2023, specifically, principle two "Public Works enabling infrastructure to build homes faster"., related to address the capital funding gap related to the Provincial government's housing targets.*

This report will address the process and requirements for undertaking debenture financing associated with the incremental capital costs of $11.1 billion required to achieve the new Bill 23 housing targets.

Ability to Finance the Servicing Shortfall of $11.1 Billion Related to the Local Housing Pledges

1. Analysis

The *Municipal Act, 2001* (the "Act"), and O. Reg. 403/02 (the "Reg") set out the requirements under which a municipality may borrow. Debenture financing may be used to finance approved capital works so long as there is an identified source of funding for the capital, including principal and interest payments.

a) Project Requirements for Undertaking Debenture Financing

Section 408(2.1) of the Act provides that debenture financing may only be used to finance a capital work or class of works. Debentures may be authorized by by-law only in accordance with the Act. Section 408(4) of the Act requires that a debenture by-law include a general levy provision which may identify specific sources of funding for repayments tied to the borrowing, including principal and interest payments. The Act does not permit borrowing for future unidentified projects. Debentures may only be issued to fund "a capital work", and the term of any debenture cannot extend beyond "the lifetime of the capital work for which the debt was incurred".

The Region has a well-defined and efficient process through which debt financing is approved and actual borrowing is executed in the capital markets. Through the annual budget process, the annual capital budget is approved, and the 10-year capital plan is endorsed by Council. As part of the approval process, capital projects are identified along with the respective funding sources.

The Region's Official Plan was approved in November 2022 and work is underway to complete water and wastewater and transportation master plans to identify infrastructure required to service the new growth associated with the estimated $11.1 billion incremental capital costs to service Bill 23 growth. This, in addition to environmental assessment work, must be completed before detailed design and construction can proceed. It is anticipated that the master servicing plans will be completed in 2025 and will identify the infrastructure projects required to service the planned growth. This work is required to be completed prior to debt issuance.

b) Legislative Requirements Related to Debt and Financial Obligation Limits

The Act allows for regulations to prescribe debt and financial obligation limits which limit the amount that a municipality may borrow to finance a capital work or class of works without the approval of the OLT. Sections 1, 2, 3 and 4 of the Reg outline debt and financial obligation limits for municipalities. The current debt and financial obligation limit is 25 per cent of a municipality's own-source revenues.

The ministry calculates 25 percent of the municipality's annual own-source revenue:

Municipal Own-Source Revenue (e.g. Property Tax, User Fees) **X** 25 % **=** 25 % of Own-Source Revenue

The ministry subtracts municipal debt and other financial obligations to determine the ARL:

25 % =of Own-Source Revenue **-** Annual Payments for Existing Debt and Other Financial Obligations (Principal + Interest) **=** Annual Repayment Limit

******Source: Ministry of Municipal Affairs and Housing; for illustrative purposes only*
***Own-Source revenue does not include development charges (DC) and some other revenues*

The annual repayment limit (ARL) governs the amount of debt service a municipality can commit to as a percentage of its own source revenue to help ensure that municipalities remain financially viable over the long-term. Before a municipality can authorize any specific capital work or class of work for which long-term debt will be required, the treasurer must calculate an updated ARL. Pursuant to section 4(9) of the Reg, where it is determined that the authorization of a new capital work or class of work would cause the updated ARL to be exceeded, Council must first obtain the approval of the OLT before authorizing the work or class of work and associated debt. Staff are not aware of an instance where an application has ever been made or the OLT has approved and increased ARL for a municipality. Staff have not discussed this matter with the Ministry.

c) Debt Capacity and ARL Limits

The Region's practice has been to take on debt to build growth related infrastructure, which the Region relies on the future stream of Development Charges (DCs) to repay that debt. This approach has been taken to accelerate infrastructure delivery to ensure that housing could be built faster in support of growth and economic development, within one of the fastest growing areas in Canada. Since 2010, the Region has issued $2,280 million (inclusive of borrowing on behalf of the local municipalities) in debt through the capital markets at a lower cost of funds relative to other available financing methods. As at Dec. 31, 2022, Regional net debt outstanding was ~$1,270 million, of which $1,110 million is DC net debt.

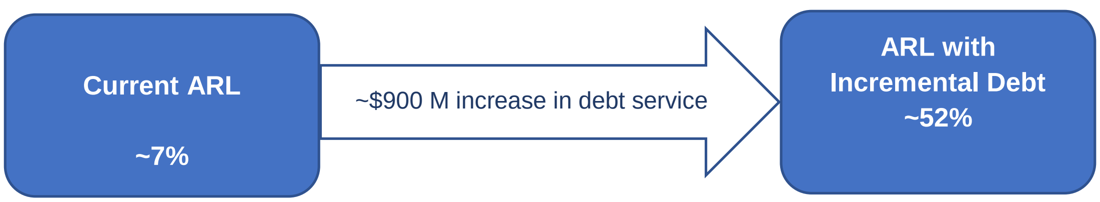
Current annual debt service (principal & interest) requirements are approximately $145 million, equating to an ARL of ~7 per cent. Based on 2022 net own source revenue estimates of $1,990 million, remaining debt servicing capacity would be approximately

$339 million per year, which would allow for ~$4,000 million in additional debt capacity assuming an average of 20-year debentures.

DC related projects are funded through DC revenues. Debt financing has historically been used to bridge the timing gap between capital spending on necessary infrastructure to support growth, and the subsequent revenue collection related to that infrastructure which typically occurs several years after the infrastructure is in place. A general practice has been to borrow through debenture issuance once projects are at the stage of substantial completion.

Based on the 2023 capital budget and 2023-2031 capital plan, the Region estimates approximately $2,100 million in additional debt financing ($1,200 million DC which is subject to change based on the outcome of the DC Appeal/Settlement, $720 million PRP, $130 million Housing) is required to support the capital plan, before the impacts of Bill 23 and the incremental cost to service the Province's new housing targets are even considered. In addition, we have been advised that the local municipalities will have significant borrowing requirements over the 2023–2031 time horizon.

Assuming an additional $11.1 billion of incremental debt was issued at current interest rates for a 20-year term, annual debt service costs would increase by approximately $900 million per year, depending on the term of the debt, an increase of existing debt service by more than 6 times the current level. This would result in the Region's debt service costs as a percentage of own source revenue, currently at approximately 7 per cent, to increase to approximately 50 per cent of the Region's own-source revenues. To bring ARL percentage below the legislative limit of 25 per cent, the Region would immediately require an additional $1,100 million in own-source revenue.



DC revenue is a primary funding source to fund capital costs related to growth infrastructure, as well as any required principal and interest payments. To accommodate growth, the Region has spent more than it has collected in the past 10 years and has used debt to manage cash flow. Further, as reported to Regional Council on December 8, 2022, Bill 23 proposes significant reductions to the Region's ability to collect DCs. Preliminary analysis estimates that the DC revenue (all services) shortfall in Peel resulting from the changes to the *Development Charges Act, 1997* could amount to approximately $2 billion over the next 10 years. The DC revenue shortfall could escalate to as high as $6 billion if the Province's housing targets are actually met as noted on the December 8, 2023 report to Regional Council, titled, "Bill 23 "More Homes Built Faster Act" and Implications for the Region of Peel". Municipalities continue to wait for the release of provincial regs/bulletin defining affordability or attainability which will be required before we can accurately estimate the true impact of Bill 23. Through the Ministry of Municipal Affairs and Housing Municipal Finances Audit, the Province and the Region will attempt to estimate the impact of Bill 23, More Homes Built Faster, 2022, on the Region's finances, if provincial housing targets for each of the Region's local municipalities are met/exceeded.

DC revenues will be insufficient to fund DC capital costs and any associated principal and interest costs given the sizable amount of debt required to fund the Province's new housing targets. As a result, the Region must identify additional funding sources (tax and/or utility rate increase) to support the incremental debt service costs, the quantum of which could not be reasonably supported by Peel tax and utility ratepayers.

d) Capital Market Considerations

The introduction of Bill 112 has created uncertainty for investors and credit rating agencies. Credit rating agencies and large institutional investors that participate in the Region's debt program have raised concerns about the lack of clarity associated with the dissolution of Peel. The primary concerns being:

1. Will the current protections under the *Municipal Act, 2001*, specifically the joint and several liability provisions be maintained post dissolution? and
2. Will bonds outstanding at the time of dissolution continue to be rated by credit rating agencies?

Clarity on these critical issues is paramount for investors and until such time as investors are satisfied, it is expected to be extremely difficult to access the capital markets for the Region's current and future financing needs. It is unclear to what extent investors would be willing to participate in a Regional debenture offering without clear guidance on the future governance structure and legislative framework post dissolution. This is especially true given the quantum contemplated by the motion before Council.

For context, the Canadian municipal market sees approximately $4 to $5 billion in annual issuance, dominated by two or three large issuers (Municipal Financing Authority of BC, City of Montreal, and City of Toronto). Even if the *Municipal Act, 2001* requirements could be satisfied, issuing $11.1 billion in Regional debentures in a single year would be many multiples of what the largest issuers in the sector are able to accomplish. Further, without a significant increase in Regional own-source revenues, the Region's financial health would be materially eroded, thereby threatening the Region's triple A credit ratings. Lastly, even if the debentures could be placed in the market, there would be material cost implications as investors would demand disproportionately higher interest rates to compensate for the extreme size of the issuance and the associated uncertainty in the Region's ability to maintain the incremental funding sources required to service the debt over the term of the debenture issuance(s).

e) Summary Analysis

In summary, the following items must be satisfied prior to debt issuance in the order set out below:

1. Identification of the capital projects to be financed
2. Budget approval and identification of the funding sources for the capital projects to be financed

3. Application to the OLT to exceed the updated ARL and receipt of approval of an increased ARL
4. Council approval to borrow and proceed with OLT approved additional debt

2. Proposed Direction

Given the magnitude of the proposed debenture, if permitted by the OLT and issued, there would be a materially significant deterioration of the Region's financial sustainability and flexibility. As a result, staff recommend that Regional Council not seek to incur long-term debt to immediately finance the servicing shortfall of $11.1 billion.

Bill 23 imposes significant change and will have a significant impact on the Region and its local municipalities. Bill 23 will fundamentally alter the Region's land use planning, infrastructure service delivery, and housing provider/service manager roles and will result in a significant loss of revenue. As a result, staff recommend that Regional Council continue to advocate to the Minister of Municipal Affairs and Housing to ensure that the Province of Ontario creates a municipal compensation fund to compensate the Region of Peel and its local municipalities in order that they be made whole because of the impacts of Bill 23 on municipal growth funding revenues and expenditures.

RISK CONSIDERATIONS

The Region remains committed to providing servicing to meet the housing targets set out by the Province in Bill 23 however, Bill 23 and the accelerated timing for the 2031 housing targets present significant challenges to the Region in delivering the required infrastructure to support growth in Peel. The increase in concurrent development projects will result in disruption to the residents, businesses and goods movement in the Region, primarily related to pipeline and road-related construction. There will be a need to retain additional internal staff resources to plan and manage design and construction as well as manage increased procurement activity, property acquisition and financial and legal services which are required to support intense capital activity. The time required to satisfy provincial requirements for environmental assessments will impact the pace of construction and provincial support will be required to mitigate this risk. Significant economic uncertainty remains with inflation at multi-decade highs, labour shortages, and supply chain challenges, all of which are contributing to a higher cost environment with significant capacity constraints. These factors represent headwinds to the Region's ability to deliver on its capital plan in a timely manner, over and above the risks imposed by Bill 23 and the compressed timing for the 2031 housing targets, the immediate long-term borrowing of 11.1 billion will not guarantee the immediate delivery of the associated infrastructure.

Financing the servicing shortfall of $11.1 billion with debenture financing within the 2023 fiscal period introduces additional financial risks. The key risks that have been highlighted in the report include the impact to the Region's ARL, insufficient DC revenue to fund the incremental principal and interest costs to support the debt and the capital market considerations, all of which pose significant challenges in implementing the motion put forward by Regional Council. Should the OLT authorize an updated ARL, the current DC revenue projections indicate that this level of debt service costs could not be met with DC revenues alone and would require an immediate and substantial increase to tax and/or utility rate funding to support the incremental debt service costs.

BILL 112 RISKS AND IMPLICATIONS

On June 8, 2023, the *Hazel McCallion Act (Peel Dissolution), 2023* (Bill112), received royal assent. The appointment of the Transition Board and development of the Terms of Reference are underway by the Ministry of Municipal Affairs and Housing. Under Bill 112, recognizing that no details have been provided as of yet, the Transition Board, once in place, will ensure that transactions and/or decisions after May 18, 2023, are made in the public interest having regard to the municipal restructuring, and are implemented in a manner that does not unreasonably impact another municipality. Sections 5 and 6 of Bill 112 prohibit the Region from acting in a manner that unreasonably impacts another municipality, including any of Mississauga, Brampton or Caledon. Should the Transition Board determine that the direction to issue $11.1 billion in long-term debt, as outlined in this report, fails to meet the requirements of Bill 112, the Transition Board retains authority to direct the Region to take steps to undo the transaction.

With the passing of Bill 112, investors have expressed concerns over participating in any Regional debt issuance pending further clarity and certainty with respect to dissolution of the Region and the management of its debt post January 1, 2025. Most notably, any implications to the current protections under the Act and the maintenance of credit ratings post-dissolution for any outstanding Peel debentures need to be addressed. Investor appetite for any new debentures remains unclear.

FINANCIAL IMPLICATIONS

The Region's growth capital program has used debt to finance its growth program largely for water, wastewater, and roads infrastructure. The Region's net DC debt outstanding at the end of 2022 was $1,270 million. The Region's DC revenues will continue to service existing debt first and capital expenditures second. Issuing $11.1 billion in 2023 would result in an increase in debt servicing requirements of $900 million per year, in addition to the current $145 million in annual debt service costs.

Utilizing debenture financing to fund the incremental costs to support Bill 23 and the Province's accelerated housing targets cannot be supported by the current and projected DC revenues as they will be insufficient. Therefore, assuming that capital projects could even be identified to satisfy the legislation, an additional funding source in the form of increased tax and/or utility rates would be required, in addition to an exemption by the OLT to increase the ARL. Further, even if the Region could secure a funding source for the incremental debt service costs and an OLT approval, the issuance of $11.1 billion and the uncertainty associated with Bill 112, would have material impacts on the Region's current credit rating and cost of funds (i.e., the rate at which the Region is able to borrow).

CONCLUSION

Bill 23 and the accelerated housing targets by the Province have introduced significant uncertainty with respect to the Region's current capital and funding plan. The motion to direct staff to issue long-term debt to finance the preliminary estimated servicing shortfall of $11.1 billion introduces significant operational and financial risks. Furthermore, Bill 112 has introduced uncertainty with respect to the Region's current and future debentures with the result that investor appetite for Peel bonds remains unclear - as does the Region's ability to raise additional revenue to fund increased debt service costs. Lastly, it is not a certainty that the OLT would even permit an increase to the ARL in the circumstances.

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