
REPORT TITLE: Capital Financing Strategy

FROM: Stephen Van Ofwegen, Commissioner of Finance and Chief Financial Officer

RECOMMENDATION

That the Capital Financing Strategy and principles outlined in the report from the Commissioner of Finance and Chief Financial Officer titled, “Capital Financing Strategy”, be endorsed.

REPORT HIGHLIGHTS

- Peel’s population is expected to grow by more than 500,000 people by 2041 which will increase service demand from all services including capital intensive services such as Housing Support, Regional Roads, Water and Wastewater.
 - Addressing service demand and growth will require significant new infrastructure over the next 20 years.
 - Funding is also required for the state of good repair of existing assets valued at over \$28 billion.
 - Service demand needs will continue to evolve as these will be impacted by climate change, the changing nature of employment, and changes in legislative and regulatory requirements.
 - The growing and increasingly complex infrastructure needs will require significant amounts of capital financing and increase pressure on the Region of Peel’s overall financial flexibility.
 - The Long Term Financial Planning Strategy provides high level direction on the Region’s overall financial health but a Capital Financing Strategy is required to provide more specific guidance on how best to finance both short term and long term infrastructure needs.
 - The proposed Capital Financing Strategy and principles provide direction as to which capital financing sources should be used to fund capital projects and capital plans.
 - The Capital Financing Strategy will ensure that the Region of Peel maximizes available funding sources and remains financially flexible to address future capital infrastructure challenges.
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DISCUSSION

1. Background

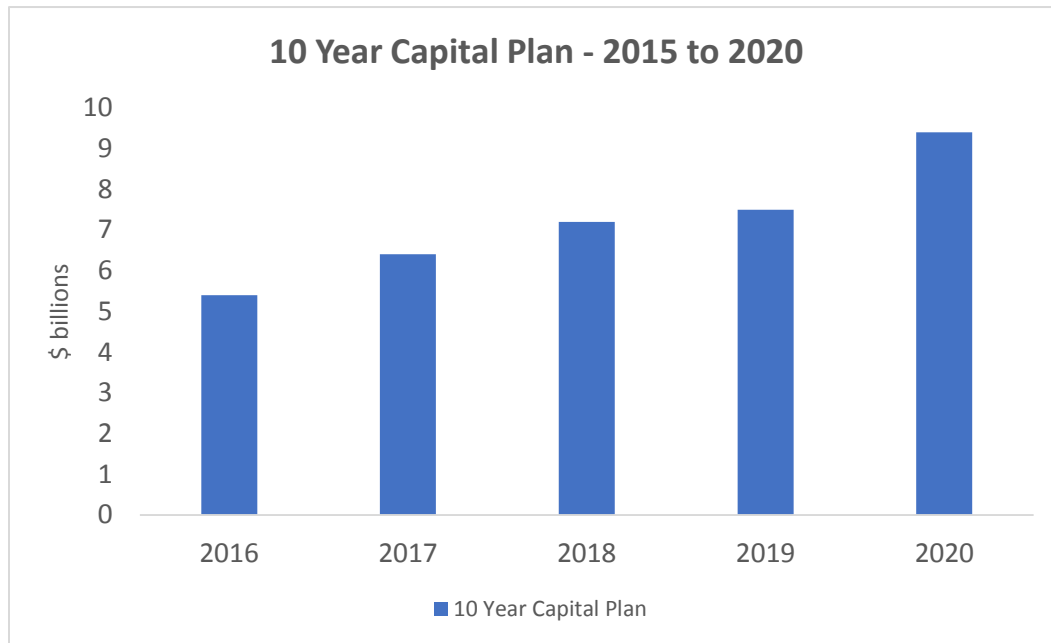
The Region of Peel (Region) delivers services that are needed by its 1.5 million residents and 182,400 businesses. The majority of these services, such as Housing Support, Waste, Long Term Care, Regional Roads, Water and Wastewater, are capital intensive. As of 2019 the Region had infrastructure assets with a total value in excess of \$28 billion and with its population expected to grow by more than 500,000 people by the year 2041, significant additional infrastructure will be needed to meet the service demands of this growing community.

Capital Financing Strategy

Peel's Growing Infrastructure Needs

As seen in Chart 1 below, this has been evident over the past five years where the Region's capital plan has increased steadily from \$5.4 billion in 2016 to \$7.5 billion in 2019 with a sharp increase to \$9.4 billion in 2020 reflecting the change in the growth horizon from 2031 to 2041. The capital plans reflect forward looking commitments to meet the service demand needs of the community and include Council's approved Water/Wastewater Master plans, Long Range Transportation Plan, Long Term Waste Management Plan and Housing Master Plan.

Chart 1: The Ten-Year Capital Plans from the Previous Five Years



While these capital plans incorporate the service demand needs understood at the time they were presented, they will continue to evolve to reflect changes in service standards, changes in legislative or regulatory requirements, climate change standards and the changing nature of employment.

For example, in 2019, the Region approved a Climate Change Master Plan that will require up to \$350 - \$400 million over the next 10 years, a Waste Management plan with an anaerobic digestion facility to reduce greenhouse gas and increase waste diversion and Council's recently approved \$1 billion Housing Master Plan to increase the supply of affordable housing to Peel residents.

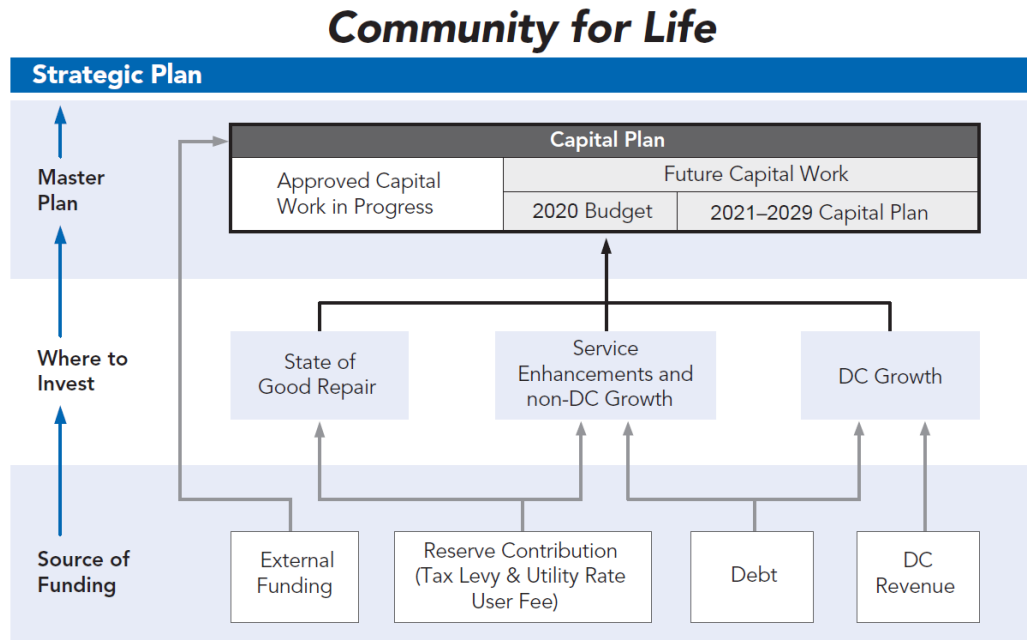
Looking out over the next 20 years, an increasing amount of complex capital infrastructure is required, infrastructure that will require significant amounts of capital financing.

Available Capital Financing Options

The Region funds its capital infrastructure needs through four main sources of financing; capital reserves, development charges, external funding and debt. These financing sources are conceptually aligned to the type of capital work they fund. Chart 2 below provides a visual of the relationship between the capital plan.

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Chart 2: Relationship Between the Capital Plan and its Sources of Financing

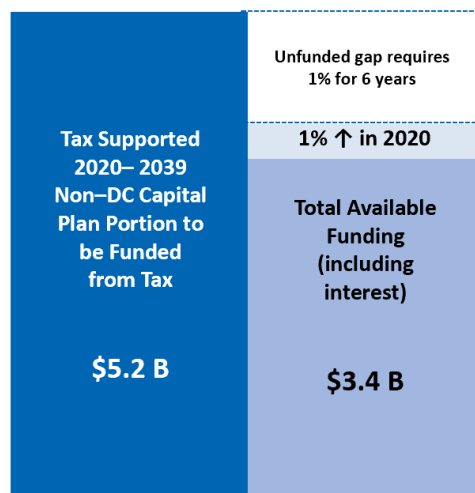


Capital reserves are generally used to fund the state of good repair, new and enhanced services levels (such as climate change, waste diversion and affordable housing) and growth that is not eligible for development charge funding. Capital reserves are funded through annual capital reserve contributions within the operating budget. As the need for capital reserves increases through increased state of good repair needs or through service level enhancements (e.g. Seniors Health and Wellness Village, new affordable housing), increases to the reserves are proposed in the Operating Budget e.g. 1 per cent infrastructure levy. As presented to Council through the 2020 Budget, Peel currently has a combined reserve shortfall of \$3.2 billion for tax and utility rate supported programs.

Chart 3: 2020 Capital Reserve Adequacy for Tax and Utility Programs

\$1.8 B - 20 Year Funding Shortfall

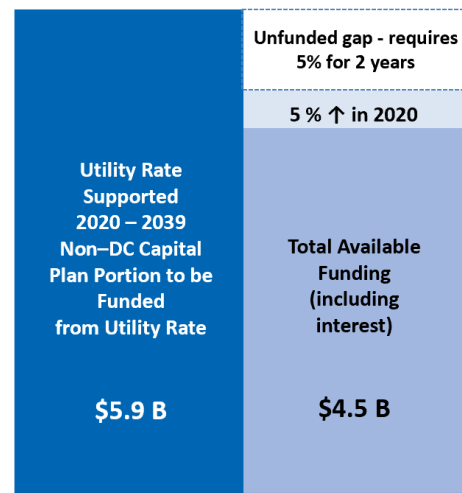
Regionally Controlled Tax



Total Asset Value: \$5.7 B

\$1.4 B - 20 Year Funding Shortfall

Utility Rate

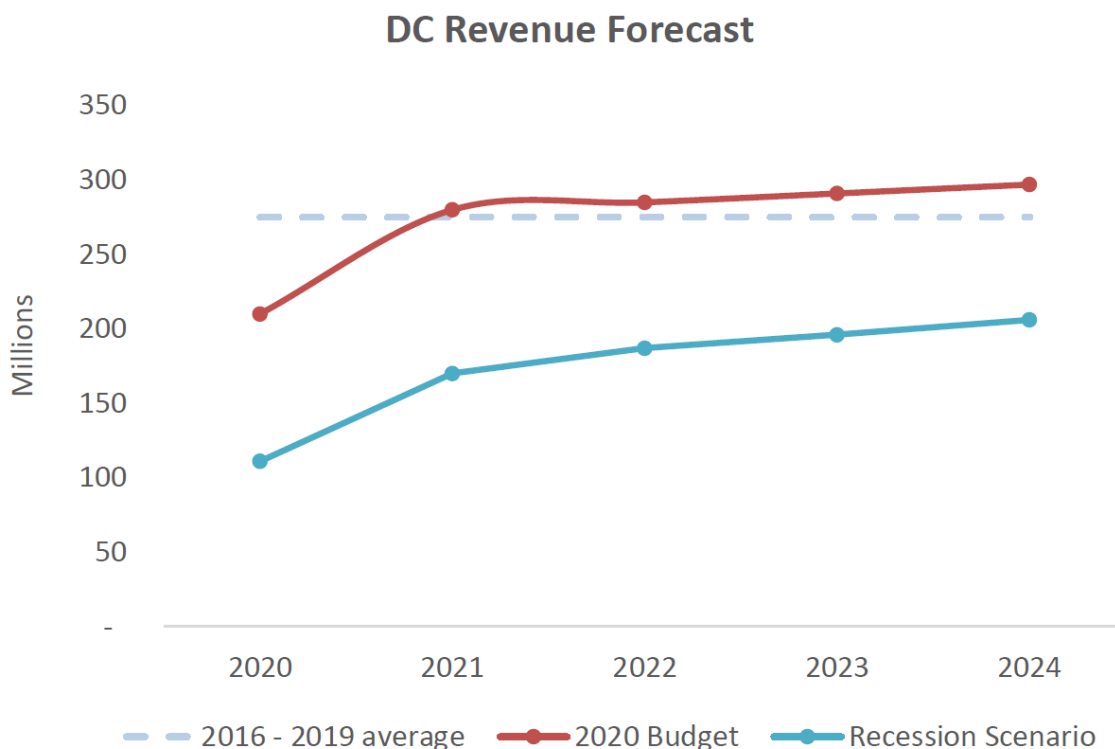


Total Asset Value: \$23.9 B

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Development Charges (DC) are used to fund growth, specifically development charge eligible growth. With each development charge background study and by-law, new and evolving service demands are reviewed to ensure that population driven needs like affordable housing are reflected appropriately. As development occurs there can be a significant difference in timing between when DCs are actually collected and when the spending to put the infrastructure in place actually happens. As seen in Chart 4 below, the recession initiated by the COVID-19 pandemic will result in a forecasted DC shortfall of \$600 - \$700 million from 2020 to 2024.

Chart 4: Development Charge Forecast 2020 – 2024

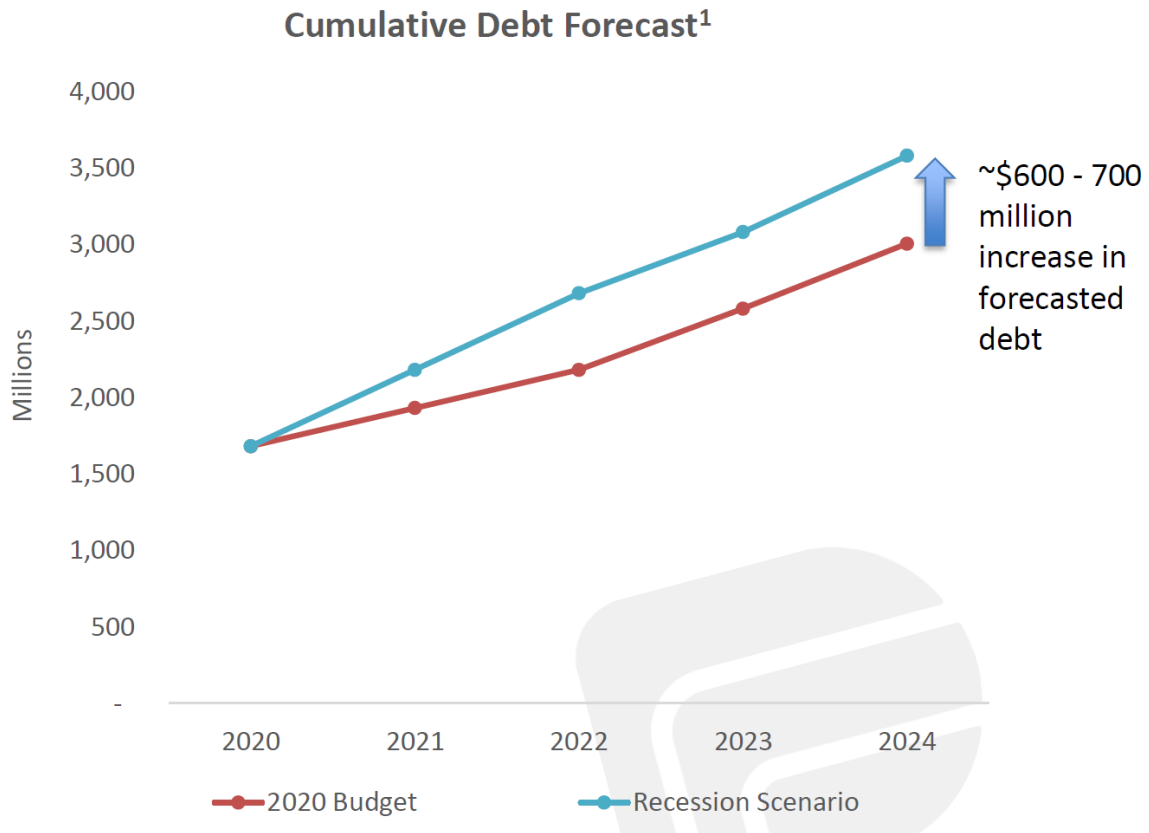


Debt has largely been used to support development charge eligible growth. Since the Region is required to build the infrastructure for services like water, wastewater, and roads prior to the development and collection of development charges, debt is used as a tool to address the difference in timing between the expenditures required and the receipt of development charge revenue.

The amount of debt that the Region can issue is dependent on how much own source revenue it can generate. According to the *Municipal Act, 2001*, the annual debt and financial obligation limit is determined under Regulation 403/02 which prescribes that a municipality cannot dedicate more than 25 per cent of its own source revenue towards debt payments. Therefore, as additional debt is issued, more of the revenue has to be committed to make the debt payments which reduces financial flexibility or debt available to finance other capital projects.

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Chart 5: 2020 – 2024 Debt Forecast



External funding, usually provided by the provincial or federal governments, has helped to address significant pressure from income redistribution programs most notably affordable housing. External funding has also been a key financing source during economic downturns as it helps to stimulate the economy.

However, due to the complex infrastructure needs of some of the services, there is often a blend of financing sources required. For example, re-building and expanding existing affordable housing can include replacing the current infrastructure, increasing the capacity due to increased demand for units and leveraging existing funding announcements. This scenario would involve all of the financing sources listed above.

DISCUSSION

As mentioned earlier in the report, with infrastructure requirements growing over the next 20 years and becoming increasingly complex, the challenge to finance those infrastructure needs also grows and becomes increasingly complex.

Council's Long Term Financial Planning Strategy, approved in 2013 and recently updated in 2019, has provided high level guidance for ensuring that capital needs have been met and also ensuring that Peel remains overall financially healthy.

Capital Financing Strategy

The Long Term Financial Planning Strategy includes nine financial principles under the financial pillars of Sustainability, Vulnerability and Flexibility. These principles have helped Peel remain one of only four municipalities with a Triple “A” credit rating from both Moody’s and Standard & Poor’s. Six of the nine financial principles (outlined in Table 1 below) provide high level direction for capital financing:

Table 1: Capital Financing Related Principles from the Long Term Financial Planning Strategy

Principle	Description
Respect the taxpayer	Achieve reasonable and responsible tax rates to ensure that Regional Council’s highest priority services are maintained. The Region will strive to deliver its desired outcomes without placing undue financial pressures on its taxpayers.
Ensure the Capital Plan is Sustainable	Capital reserves and reserve funds are funded to levels to enable the Capital Plan. Capital expenditures should be continually reviewed in the context of affordability, and the operating impact of capital should be sustainable and affordable.
Manage Assets	Replace or maintain assets over their lifecycle in a timely manner to enable service delivery.
Users Pay Where Appropriate	Ensure that the users of services pay for the services, and balance growth-related investments with revenue to achieve intergenerational equity where possible.
Mitigate significant fluctuations in tax and utility rates	Implement ways to smooth and maintain tax and utility rates to provide financially stable and predictable environments for residents and businesses.
Borrow when appropriate for capital infrastructure	Maintain an affordable level of debt required to achieve desired service levels while minimizing the impact of borrowing to the taxpayer and ensuring intergenerational equity.

PROPOSED DIRECTION

While the principles of the Long Term Financial Planning Strategy provide high level guidance, a strategy focused specifically on capital financing that is aligned to the Long Term Financial Planning Strategy will help to ensure Peel maximizes its available funding sources and remains financially flexible to deal with future capital infrastructure challenges. The following five principles are proposed to help guide how best to finance capital plans and capital projects:

1. Preserve Flexible Financing Sources

Use the financing sources that have the most eligibility criteria first. Financing sources such as external funding, development charges and reserve funds have very explicit criteria that must be met in order to be used. By utilizing these types of financing sources when possible, more flexible financing sources such as capital reserves can be kept available to future unknown requirements.

Funding criteria can include time restrictions (completion by a specified date), type of capital expenditure (e.g. growth or replacement) and type of program (e.g. housing, water, wastewater, waste management). An example is the use of Federal Gas Tax, which can only be used for specific programs such as TransHelp and Waste

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Management. By using the Federal Gas Tax first, it allows more capital reserves to be available to fund other capital work for which there may not be other sources of funding.

2. Enable Funding from Upper Levels of Government

For capital initiatives that align to outcomes from upper levels of government such as income redistribution and stimulating the economy, the Region of Peel will develop financing plans that provide opportunities for the upper levels of government to contribute funding that matches their respective levels of responsibility.

For example, under income redistribution, the proposed funding for Council's \$1 billion Housing Master Plan identified that Peel provide one-third funding leaving one-third for each for the Provincial and Federal governments to fund. This enabled additional advocacy to secure additional funding from the federal government. Another example of where this has been successful is the positioning for Economic Stimulus funding in both the 2018 and 2019 Capital Budgets. Peel included capital projects that were budgeted with half the funding from Peel and half the funding coming from external sources. This enabled its eligibility for the Clean Water and Wastewater Funding and allowed capital reserve financing to be matched with federal capital grants.

3. Strive for Intergenerational Equity

A key goal must be to ensure, as best as possible, that the residents or businesses that benefit from the capital infrastructure pay for that capital infrastructure. If an asset will service new users then the new users should bear the financial cost of the asset and not the existing users. This helps to ensure intergenerational equity. An example where this principle is currently used is the financing of growth infrastructure through Development Charges.

Another example where this principle could be applied is in funding long term programs such as Climate Change. Residents and businesses should be contributing to programs and/or initiatives to help reduce their carbon footprint.

4. Leverage Debt for Revenue Generating Assets

If an asset is expected to generate ongoing revenue then debt should be leveraged as a financing source to the degree that the revenue can fund the debt. This helps to maintain financial flexibility as it does not commit the usage of property tax or utility rate fees to fund the debt.

For example, in Housing Support, where there are true market rent units, debt could be used as these units can generate sufficient revenue to fund any associated debt. This decreases the need for capital reserves. Another example could be to leverage debt for waste management programs expected to generate user fees such as the future anaerobic digestion facility.

5. Minimize the Impact to Tax and Utility rate payers

When considering the type of financing to be used for a capital project or plan, it is critical to be mindful of the impact to the average tax and rate payer. It should not result in unaffordable increases as these are not sustainable in the long term.

Capital Financing Strategy

As articulated during the 2020 Budget Overview, Peel currently has a 20-year reserve adequacy gap of \$1.8 billion for tax supported programs and \$1.4 billion in utility rate programs. Instead proposing one-time increases of 6.3% and 13.6% for tax and utility respectively, the needed increases will be phased in over the next several years.

While each of the above principles are important, the principles should be considered as whole when determining the best approach to financing a capital asset. No one single principle should be considered in isolation. By applying these principles to financing significant capital projects and capital plans, Peel will be able to enable critical services to be maintained while remaining financially flexible to deal with future service enhancement and growth.

CONCLUSION

The Region of Peel's growing population and evolving environment will drive increased service demand and with it, increased capital infrastructure needs. The adoption of the capital financing strategy and its principles will ensure Peel maximizes its funding sources and remain financially flexible to address future capital infrastructure challenges.

For further information regarding this report, please contact Norman Lum, Director Business & Financial Planning, Ext. 3567, norman.lum@peelregion.ca

Authored By: Norman Lum, Director

Reviewed and/or approved in workflow by:

Department Commissioner, Division Director and Financial Support Unit.

Final approval is by the Chief Administrative Officer.



N. Polsinelli, Interim Chief Administrative Officer