
TO: Members of Council

FROM: Mayor Lehman

RE: Funding Strategy for Capital Plan

DATE: April 7th, 2014

The purpose of this document is to outline an alternative funding scenario for our 20-year capital plan. For several years, City staff have been compiling the anticipated capital plan associated with both the City's growth and the badly needed asset management work to reduce or eliminate the infrastructure deficit. There is now a comprehensive list of projects, and costing associated with each, which was summarized in the Fiscal Impact Analysis (FIA) prepared by Watson and Associates as part of the comprehensive *Building Barrie* Growth Management exercise.

As you are aware, the FIA preferred fiscal scenario achieves three of four financial targets (associated with limits on tax and water increases, and on debt to revenue ratios). However, the amount of debt required to achieve the capital plan exceeds one of the four measures (debt to revenue ratio). The debt payments within the plan as prepared also will put substantial pressure on the tax based operating budget over the coming years.

There are a few implications of this. This scenario also assumes that the financial tools that have been approved for negotiation with the development community will be implemented. Clearly, there is no ability for the City to take on any additional costs associated with growth. We will need growth-related costs to be covered by the development community to a greater degree than in the past.

The capital projects are in three categories:

- **New Assets – Growth Related** - these are 100% associated with growth and costs, per the above, need to be paid by the development community to the greatest extent possible. The proposed financial tools that are being discussed with the landowner's groups are intended to cover the vast majority of these costs.
- **New Assets – Existing Benefit** – these are projects that are due both to growth and the need to increase capacity due to shortcomings today. Examples would include Mapleview Drive from Huronia to Yonge Street, and Huronia Road. This category includes many projects Council has indicated should be a priority as they include “catch up” from previous growth as well as future pressure. The City is required to pay for the portion of these projects that benefit the existing residents/businesses. Also in this category are certain non-DC eligible projects, although these are a very small portion of the total cost.
- **Existing Assets** – this is asset management or “fixing what we've got”. Costs are entirely borne by the City.

For the tax based projects (excluding water and wastewater projects), the Fiscal Impact Analysis and the 20-year capital plan includes City-borne costs as follows:

- **New Assets – Growth Related** – none
- **New Assets - Existing Benefit** – approximately \$645M to 2031
- **Existing Assets** - approximately \$1,300M to 2031

Recognizing that this level of spending on existing assets is likely to be unaffordable, staff have also produced a reduced scenario that completes 100% of extreme and high risk projects, but only 9% of medium and low risk projects. This scenario totals some \$900M by 2031.

As noted, however, even this reduced spending plan represents a dramatic increase in the amount of funding committed annually to asset management, and results in serious fiscal pressures. Secondly, the reduced plan does not eliminate the infrastructure deficit – there will still be a \$400M shortfall at the end of the plan, in 2031. These are obviously offsetting pressures.

In addition to these costs, the FIA identifies a need to set aside funding for the replacement of new assets within the forecast period. For example, if a new snowplough is required to handle new roads built in the annexation lands, that vehicle will need replacing within the forecast period. While the initial cost of the snowplough is covered largely by development charges, the replacement of this vehicle is not.

In my opinion, this asset management and asset replacement plan as presented is too expensive in the early stages of the plan, but does not prioritize spending enough in later years to eliminate the deficit.

What is needed is a plan that sees the city increase its asset management spending gradually, ultimately reaching a higher level than planned, while limiting growth-related spending to the amount identified in the plan, not more. The capital plan needs to reflect the need to limit spending to what is affordable in the short term, to allow time for sufficient revenues to be available on an annual basis to accomplish the level of asset management and replacement identified.

We have frequently been told that the City needs to be spending in the order of \$85M per year or more on asset management and/or replacement of existing assets. We are currently spending \$30M. We must make up this gap. But this can only be accomplished by ramping up the City's contribution to the tax capital reserve over time. Fortunately, with the passage of time, and if successive Councils remain committed to this plan, the infrastructure deficit can be reduced and ultimately eliminated in Barrie.

In order to reduce debt in the capital plan, more infrastructure needs to be paid "as we go". This means increasing the transfer to reserves and maximizing use of all external funding to increase revenues available to the capital plan. The key elements are:

- Ramp up tax capital contributions from operating budget over time by:
 - Reinvest savings from debt retirement into asset management
 - Gradually increasing the transfer to reserve amount in the operating budget
- Include federal and provincial infrastructure funding (eg. Build Canada II, provincial cost-sharing of highway projects)
- Use of Infrastructure Ontario construction financing prior to the issuance of long-term debt
- 25 year plan instead of 20 years to reflect affordability, but also to allow a greater amount of asset management work to be completed and the infrastructure deficit reduced.

Increasing Tax Capital Reserve Contributions

The Long-Range Financial Plan includes policies to increase the transfer to the tax capital reserve every year. However, this reserve has been drawn down over the past ten years to fund capital projects, and for the foreseeable future, any increases in this transfer need to be used to fund capital projects rather than build the balance in this reserve.

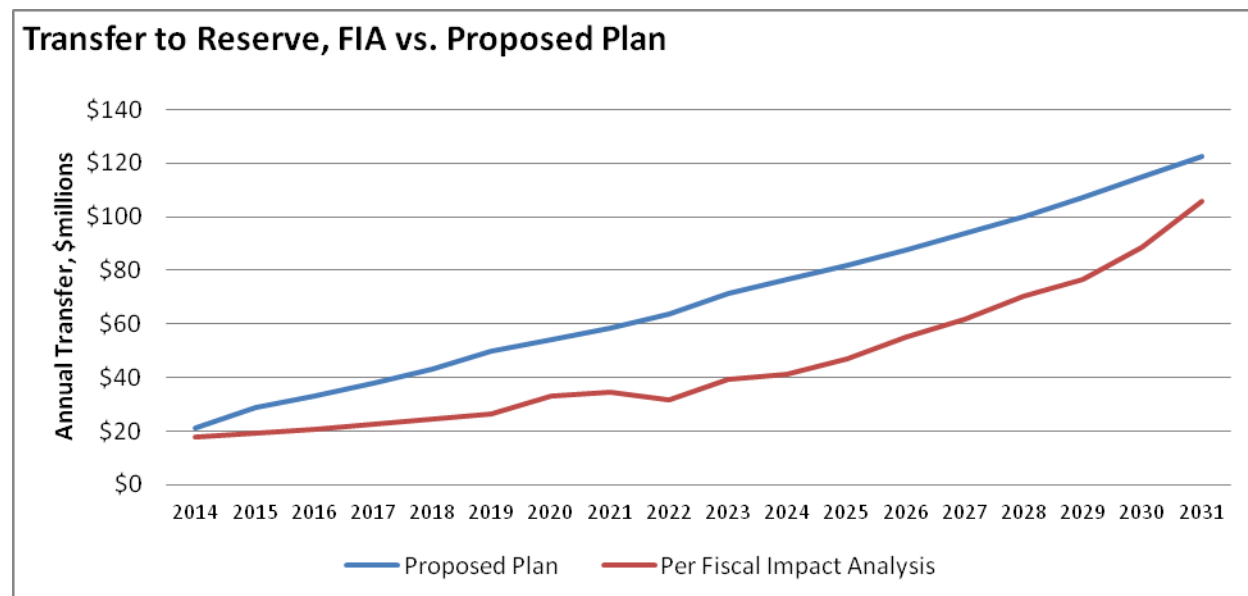
In Budget 2014, this contribution was increased by \$2.5M, to a total of about \$21M. If this rate of increase were maintained, for example, in 2034 the transfer to reserve would total \$61M annually, still short of the annual amount needed.

I'm proposing that this amount be substantially increased. Ways to do this would include:

- **Allocating debt retirement budget room.** The LFRP currently states that when debt is retired, the budget room created be used to fund asset replacement. As such, applying it to the capital plan would be consistent with the policy, however, it would be applied immediately to fund the capital plan (not just asset replacement). In 2015, for example, we will be retiring \$2.2M in annual debt payments, and there is debt retirement in 2019 and 2023 as well.
- For a 5 year period, **allocate \$2M of Powerstream dividends** toward immediate priority capital projects. Barrie will have fulfilled its equity commitment to Powerstream Solar as of the end of 2014. Powerstream Solar is forecasting the repayment of equity as well as a dividend stream beginning next year; in addition, the dividend from the core business remains in excess of \$3M annually. The balance of Powerstream dividends should be made available for strategic projects.
- **Allocate annual savings from the upload of Ontario Works** toward immediate priority capital projects. These savings are in the amount of \$1.2M annually and are currently being passed on to the City through reduced operating budget requests by the County of Simcoe.
- **Gradually grow the additional \$2.5M annual contribution.** With the above steps, there is little room to aggressively increase this amount without putting pressure on the tax rate. However, growing this amount gradually from \$2.5M in 2014 to \$5M by 2022 seems realistic given forecast assessment growth that should begin in 2017-2018. Beyond 2022, the assumption for this scenario was for growth of this amount by 7% annually, which is a slightly less aggressive growth rate than identified in the latter years of the analysis in the FIA.

The total of the above steps changes the tax capital contribution considerably, compared to the Fiscal Impact Analysis. Growth will bring additional assessment, producing more tax revenue annually. However, there are increased service costs associated with a larger population and more roads, parks, and so forth to maintain. These costs are forecast to require the additional funds from assessment growth to remain in the operating budget.

It's important to note that the above are suggested options to allow for the increased transfer to reserve. Every annual budget exercise would represent an opportunity for the Council of the day to change the sources of additional funding as circumstances permit; what is important is that the City would need to remain on this path in terms of additional transfers.



Federal and Provincial Infrastructure Funding

The Fiscal Impact Analysis assumes a total of just \$40M in funding from senior levels of government for the entirety of the capital plan. It is likely that funding would considerably exceed this amount, although forecasting the actual level is impossible. That said, Barrie’s per capita allocation under the recently announced Building Canada 2 Fund should be approximately \$60M over the next ten years. In addition, Provincial cost-sharing of the 11 interchange/bridge projects on Highway 400 is likely, and it seems likely that project funding may also be available from the Province for at least some other projects. The City is receiving approximately \$34M from the Federal and Provincial governments for the Duckworth/Highway 400 project.

Based on recently released details about the Building Canada 2 Fund, and both current and historic levels of support for infrastructure projects, it seems appropriate to make an assumption of at least some senior government support as part of the plan.

Infrastructure Ontario Construction Financing

The City should investigate the use of construction financing by Infrastructure Ontario in the short term. This can significantly reduce interest costs in the short term, because rates are typically much lower. The current posted rate for municipalities for IO’s construction loans is 1.59%. For example, the City could access Infrastructure Ontario financing for projects in the early years of the plan, to allow for the completion of badly-needed projects such as the urbanization of Essa Road and Huronia Road. Infrastructure Ontario financing is then rolled into debt after 5 years; this will allow more time for assessment revenues to start coming on stream and fiscal capacity to increase.

Timing of Asset Management Work

As noted above, in my opinion the proposed asset management plan cannot be accomplished affordably, because it requires too much funding in the early years of the plan for tax-funded projects. In addition, the proposed plan does not actually eliminate Barrie’s infrastructure deficit – in 2031, there would still be a \$400M backlog of infrastructure work.

Staff recently presented the asset management capital plan to 2031 and the capital plan to 2041 to Finance Committee (see Appendix A). Asset management requirements are forecast to ease slightly after 2031. As such, re-examining the timing of the asset management plan to reflect the need to allow for a ramp-up of “pay as you go” funding sources seems appropriate. A 25-year or 30-year plan may be

considerably more affordable than the proposed 20-year plan, and ultimately allow more work to be completed as more fiscal capacity exists in later years of the forecast period (although some project would no doubt need to be delayed beyond their optimal timing) – and all of this depends on Council decisions over the coming years and decades!

As with the proposed Asset Management Plan, the pace of contributions to asset replacement needs to be built more gradually than in the proposed plan. This could entail assuming (or in practice, requiring) a longer useful life for some assets within the forecast period. However, the asset replacement forecast for new assets in the FIA is based on a 2012 start year and likely needs to be revised to reflect updated timelines and/or analysis of the useful life of assets.

Comparison of Fiscal Impact Analysis Scenario and Alternative Scenario

The alternative scenario presented above will allow a considerable reduction in the requirement for debt to fund the capital plan. While it puts some additional pressure on the operating budget to fund a more aggressive contribution to the capital budget, the requirement for long-term debt can be substantially reduced, while short-term debt at lower interest rates and much lower principal amounts could provide interim financing to allow badly needed projects in our City to proceed. This will help protect the City's credit rating and put the City on a more sustainable fiscal path. By reducing debt charges, which are carried in the tax-based operating budget, the scenario would also reduce the scale of tax increases required to support capital needs.

The alternative scenario maintains the proposed spending plan for “existing condition – growth related” projects, allowing the City to proceed with long-needed upgrades to major roads and other projects which will have both a growth-related component and benefits to existing residents, and which would be the subject of cost-sharing agreements as part of the forthcoming Secondary Plans.

Risk

The only certainty about forecasts of any kind is that they will be wrong; actual results will always vary from forecasts for a multitude of reasons. However, the use of conservative but reasonable assumptions is the best defense against substantial variances in actual results.

For example there is a risk that Federal/Provincial funding would not be available at the rates suggested. While uncertain, the amounts included reflect recently announced infrastructure funds and provincial cost-sharing for recent projects.

There are risks associated with extending the timeline for asset management works. A longer timeframe pushes some infrastructure repairs out beyond optimal timeline, generating an increased risk of additional costs due to short-term or emergency repairs. This is mitigated by ensuring extreme/high risk works are completed on schedule; any revised capital plan should ensure that these critical works are completed on time and not further deferred.

Proposed Next Steps

The assumptions for this scenario have been reviewed with City staff, but the dollar value impacts of this scenario have not been analyzed by Watson and Associates or City staff. If Council is supportive of this alternative plan, I'd suggest this be analyzed by staff and the consulting team, to verify assumptions and evaluate the impact in terms of debt reduction and mitigation of tax pressure.

It should be noted that this scenario also assumes the full adoption of the financial tools to support growth-related costs by the development community. Growth must pay for growth.

The whole purpose of developing and analyzing a scenario like this is to establish whether or not a more aggressive "pay-as-you-go" funding plan, coupled with stretching the capital plan over a slightly longer period, could reduce the amount of debt required and associated pressure on both the City's credit rating and our taxpayers. In my opinion this is the path we need to put the City on to ensure a more sustainable financial future for the organization, and lessen the burden on our residents.



Mayor Jeff Lehman