Memorandum

To	Kate Rowe
From	Gary Scandlan
Date	September 8, 2021
Re:	Denis St. Pierre Water Pollution Control Plant Expansion Financing

Fax ☐ Courier ☐ Mail ☐ Email ☒

1. Introduction

1.1 Introduction

The Municipality of Lakeshore completed a water and wastewater master plan in 2018 which identified the need to expand the water pollution control plant on Rourke Line Road in Belle River. Subsequently in 2019, an environmental assessment was completed which identified the anticipated wastewater capacity needs to 2040 for new growth and existing homes that would connect to the system. Currently, the Municipality is seeking approval for award of the tender for construction of the plant expansion.

The Municipality retained Watson & Associates Economists Ltd. (Watson) to undertake a review of financing options for the upcoming Denis St. Pierre Water Pollution Control Plant Expansion project.

1.2 Overview of the Project

As noted, the Denis St. Pierre Water Pollution Control Plant is located in Belle River. This plant currently provides service to approximately 25,000 residents. The proposed plant expansion would allow for enough capacity to service anticipated growth in Belle River and Wallace Woods, along with existing properties in Belle River.

The capital cost anticipated in the environmental assessment and 2020 development charge (D.C.) study was approximately $30 million. This was based on construction

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and associated tender prices in 2018/2019. The COVID-19 pandemic has been a significant factor in the increase in tender prices for construction. There is no anticipated change in the scope of the project; the increase in cost is reflective of the increase in construction/tender prices. The revised estimate based on current tender prices is $53.90 million. Based on the analysis in the 2020 D.C. background study, this project is considered 90% growth-related. Therefore 90% of the costs are to be funded from the wastewater D.C. reserve fund. As a result, $48.51 million of the costs are to be funded from the wastewater D.C. reserve fund and $5.39 million is to be funded from existing rates/reserves.

Project Cost	2020 Estimated Cost	Current Tender Prices
Total Cost of Project	28,800,000	53,900,000
Growth Share (90%)	25,920,000	48,510,000
Non-growth Share (10%)	2,880,000	5,390,000

To date, $8.5 million has been spent from non-D.C. reserves/reserve funds. This results in an overcontribution of $3.13 million. The D.C. reserve fund should pay back these reserves in the amount of $3.13 million ($2.97 million to the federal gas tax reserve and $155,018 to the wastewater reserve). The remaining amount to be financed ($43.69 million) would be 100% growth-related. The following table provides for a summary of the adjustments noted above:

Source of Funding	Funding to Date	Total Funding Allocated by Source	Adjustments
Wastewater Reserve	5,545,018		155,018
Federal Gas Tax	2,970,000		2,970,000
Sub-total Non-growth Reserves	**8,515,018**	**5,390,000**	**3,125,018**
Wastewater DC Reserve Fund	1,700,000		- 3,125,018
Sub-total Growth Reserve Fund	**1,700,000**	**48,510,000**	**- 3,125,018**
Total	**10,215,018**	**53,900,000**	**-**

1.3 Purpose of this Memo

This memo has been prepared to provide an analysis of three potential financing options:

1. Finance the remaining amounts with external debt only;

2. Finance the remaining amount using internal reserves and reserve funds (internal financing) only; and
3. Utilize a combination of external debt and internal financing.

Each of these options are discussed in further detail below.

2. Current Financial Situation

Debt Financing Capacity

To determine if use of external debt is a feasible option, a review of the Municipality's current debt capacity limitations was undertaken. Municipalities in Ontario have an Annual Repayment Limit (A.R.L.) which denotes the maximum debt payment amount (principal and interest) a municipality may incur. For most municipalities this is set at 25% of their own-source annual revenues (property taxes, user fees, and investment income) less annual long-term debt payments and other long-term financial obligations.

For Lakeshore, the 2021 A.R.L. is $10,282,220. This means the Municipality may assume additional long-term debt as long as the additional payments do not exceed $10,282,220. Based on a financing rate of 3% and estimated payback period of 20 years, this would equate to issuing debt for approximately $153 million. Some municipalities have internal policies with respect to setting their own debt capacity limit. Through discussions with Municipal staff, Lakeshore does not currently have an internal policy on their own debt capacity limit. Based on Watson's experience with assisting municipalities in financial matters for over 30 years, a reasonable internal policy limit would be 20%. Based on the same parameters and using a 20% debt capacity limit the maximum loan obligation the Municipality could receive would be approximately $112 million.

Along with the need to finance the plant expansion, the Municipality may also be considering expenditures of $15 million to $20 million related to construction of a new Municipal building. Given no other significant expenditures have been identified at this time, the Municipality would appear to have the capability of financing the plant expansion project with external debt.

Reserve and Reserve Fund Balances

To review if the Municipality has the ability to finance the construction project by using internal reserves and reserve funds, a review of the anticipated 2021 year-end balances was undertaken. It is anticipated that at the end of the year there will be a total of approximately $12.53 million in obligatory reserve funds (of this amount, $1.86 million relates to the wastewater development charges reserve fund and $2.17 million relates to the water development charges reserve fund), $14.69 million in discretionary reserve funds for water, a negative balance of $925,000 in discretionary wastewater reserve funds, and $2.23 million in other discretionary reserve funds. Further, there will be an anticipated amount of $41.37 million in reserves providing for a total of $69.79 million in all Municipal reserves and reserve funds[1].

The majority of these reserves and reserve funds have been established for purposes other than wastewater services. In addition, given the negative balance in the wastewater non-D.C. reserve funds, any amounts utilized for the plant expansion project, would require an internal loan between reserves and reserve funds which would be paid back with interest.

Through discussions with Municipal staff, some policies are in the process of being developed, however, there are no Council adopted policies with respect to the use of specific reserves and reserve funds for purposes such as the plant expansion.

3. Financing Options

As noted, three financing options are provided in this memo. Each option is discussed in further detail with respect to the following criteria:

- Potential Benefits
- Potential Issues
- Equity
- Additional Costs
- Debt Repayment Limit Considerations
- Municipal Policy Considerations

[1] Based on the anticipated reserve and reserve fund balances as per the 2021 budget. See attachment 1.

A table summarizing the options is provided at the end of this memo.

3.1 External Debt

3.1.1 Overview

Municipalities have the ability to enter into long-term debt arrangements to finance capital projects such as the plant expansion. Debt financing may be arranged through a number of sources including Infrastructure Ontario and private banks.

Infrastructure Ontario

Infrastructure Ontario (I.O.) is a Crown agency of Ontario which provides financing opportunities for Municipalities to undertake capital projects. The majority of municipalities throughout Ontario utilize for I.O. for major capital lending. Current interest rates on a 20-year loan are approximately 2.4%. These loans are not “recallable” meaning the payments are locked in for the entire term of the loan.

Private Banks/ Publicly Issued Debentures

Municipalities may also seek financing from private banks or through publicly issued debentures. These loans act similar to other loans whereby principal and interest payments are made on a monthly, semi-annual, or annual basis. Interest rates depend on the Municipality’s credit rating. Current interest rates provided are in the range of 3% depending on the specific terms of the agreement, with an added cost of around 0.5% for the cost of issuing debentures.

3.1.2 Potential Benefits

The interest rates available to the Municipality are at historic lows. As a result, financing significant capital projects with debt has a smaller financial impact than if interest rates were higher. For example, on a $43.69 million loan at 2.4% interest over 20 years, the total interest costs would be approximately $11.83 million. Note: as this amount is considered to be 100% growth-related, none of the interest costs would be borne by rate payers and the total $11.83 million would be funded through development charge revenues.

3.1.3 Potential Issues

Financing this project with external debt will add interest costs to the project, however, as noted the interest would be financed by development charges.

3.1.4 Equity

From an equity perspective, financing the project with debt allocates the payments across 20 years. As 100% of the debt financing would be related to new development, this would allow for annual development charge revenues to be used against the growth-related debt payments. This would also help ensure that non-wastewater reserves and reserve funds are not cash-flowing the costs of a wastewater project.

3.1.5 Additional Costs

As noted, there are additional costs in the form of interest applied to any debt financing. However, this interest cost would be added into the development charge calculations and funded from development charge revenues.

3.1.6 Debt Repayment Limit Considerations

Currently the Municipality is at about 6.4% of their debt capacity (25% A.R.L.). With the addition of a $43.69 million loan for 20 years at 2.4% interest, the Municipality would be at 11.3% of their debt capacity. This leaves ample room for further debt obligations and the Municipality to remain below 20% of their debt capacity.

3.1.7 Municipal Policy Considerations

It does not appear that the Municipality has specific policies related to external debt financing.

3.2 Internal Financing

3.2.1 Overview

Rather then financing the project using external debt, the Municipality may consider utilizing existing reserves and reserve funds to finance the project. This would require an “internal loan” to the wastewater development charge reserve fund, which would be paid back with interest.

3.2.2 Potential Benefits

Internal financing would allow the Municipality to set their own payback period for the loaned amounts. In addition, any interest costs would be included in the development charge calculation and funded by growth. These interest costs would then be paid back to the reserves/reserve funds that leant the funds.

3.2.3 Potential Issues

In total, the Municipality is anticipated to have $69.79 million in reserves and reserve funds at the end of 2021. Internal financing of $43.69 million would reduce the Municipality’s cashflow by approximately 63%. As well, the funds have been set aside for specific purposes (e.g. winter control, asset replacement, etc.). Consideration of the use of these funds must be considered over the period for which the municipality wishes to finance the loan. Using some of these other funds for the Denis St. Pierre project may then require financing for the projects for which the reserves were initially established.

3.2.4 Equity

Internal reserves and reserve fund balances (excluding D.C. reserve funds and parkland dedication) are comprised of contributions from existing tax and rate payers. As the remaining amount to be financed is related to growth, use of internal reserves and reserve funds would result in existing taxpayers and rate payers financing costs related to development.

3.2.5 Additional Costs

Additional costs to the Municipality would be limited to interest on the internal financing, however, as the interest costs would be funded from development charge revenues, there would be no impact to existing tax and rate payers.

3.2.6 Debt Repayment Limit Considerations

Internal debt financing would not impact the Municipality's debt capacity or A.R.L.

3.2.7 Municipal Policy Considerations

It does not appear that the Municipality has specific policies related to external debt financing. From an overall perspective, the financial stability of the municipality is reduced.

3.3 Combination of Internal and External Financing

3.3.1 Overview

A third option has been considered with respect to financing the construction of the water pollution control plant. This option considers a combination of internal and external financing. The exact amount to be obtained through each method of financing would be determined subsequently upon further review by finance staff.

3.3.2 Potential Benefits

When compared to the previous two options, the benefits from using a combination of funding sources would be similar. The municipality would receive some benefit by reducing the amount locked into a long-tern loan while also benefitting from the low interest rates available on the share that is financed externally.

3.3.3 Potential Issues

Similar to the option of full internal financing, the Municipality would need to consider cashflow implications and the use of funds intended for other purposes.

3.3.4 Equity

As the remaining amount to be financed is related to growth, any use of non-growth-related internal reserves and reserve funds would result in existing taxpayers and rate payers financing costs related to development.

3.3.5 Additional Costs

Additional costs to the Municipality would be incurred for interest on the internal and external financing amounts, however, as the interest costs would be funded from development charge revenues, there would be no impact to existing tax and rate payers.

3.3.6 Debt Repayment Limit Considerations

Currently the Municipality is at about 6.4% of their debt capacity (25% A.R.L.). If the Municipality external financed an amount up to $43.69 million, the Municipal debt capacity would be no more than 11.3% of their debt capacity. This leaves ample room for further debt obligations and the Municipality to remain below 20% of their debt capacity.

3.3.7 Municipal Policy Considerations

Similar to the previous options, it does not appear that the Municipality has specific policies related to allocation of funds for internal and external debt financing.

4. Recommendations

As presented above, three options were considered for financing of the remaining $43.69 million for the Denis St. Pierre Water Pollution Control Plant:

1. External financing (debt);
2. Internal financing; and
3. Combination of internal and external financing.

Use of internal financing will reduce the Municipality's cashflow and provide that existing tax and rate payers will be financing (at least in the interim) costs related to new development. Further, utilizing a combination of internal and external financing would reduce the impacts on equity and cashflow, however not to the extent financing the entire project with external debt would.

Based on the information presented above and Watson's experience with municipal finance, it is recommended that the Municipality consider the use of external debt financing for the outstanding $43.69 million in growth-related costs. The use of external financing has the following benefits:

- Does not impact the Municipality's current cashflow;
- Ensures growth pays for growth by paying the debt payments from the D.C. reserve fund over time as growth proceeds;
- Does not significantly limit the Municipal debt capacity;
- Interest costs may be funded through development charges; and
- Reserve and reserve funds are preserved for their intended purposes.

A table summarizing the various scenarios is provided below.

Table 1: Summary of Financing Options

Criteria	External Debt	Internal Financing	Combination of Internal and External Financing
Potential Benefits	• Low interest rates	• Ability to select own payback period without change to interest rate • Interest costs flow back to Municipal reserves and reserve funds	• Low interest rates on the balance external financed • Ability to select own payback period without change to interest rate on internal financed amounts • Interest costs flow back to Municipal reserves and reserve funds on internal financed amounts
Potential Issues	• Added interest costs ($11.65 million)	• Added interest costs ($11.65 million) • Reduce cashflow by 63% • Funds may not be available for the intended use of the reserve/reserve fund as it has been loaned	• Added interest costs ($11.65 million) • Reduce cashflow by an amount up to 63%
Equity	• Able to have growth pay as development proceeds	• Existing tax and rate payers would cash flow growth-related costs	• Combination of growth paying for growth, with the internal financed amount being funded by existing tax and rate payers

Criteria	External Debt	Internal Financing	Combination of Internal and External Financing
Additional Costs	• Interest costs, however, paid through D.C. revenues	• Interest costs, however, paid through D.C. revenues	• Interest costs, however, paid through D.C. revenues
Debt Repayment Limit Considerations	• Would increase from 6.4% current debt capacity to 11.4% debt capacity	• No impact	• Would increase from 6.4% current debt capacity up to 11.4% debt capacity (depending on the amount financed externally)
Municipal Policy Considerations	• N/A	• Overall financial stability of the municipality is reduced if reserve/reserve funds used	• Overall financial stability of the municipality is reduced if reserve/reserve funds used

2021 Budget

Reserve and Reserve Funds

	Projected Opening Balance	Contributions	Operating and Capital Draws	Estimated Development Charges To Be Collected	Estimated Transfers between Funds	Projected Closing Balance
Obligatory Reserve Funds						
Parkland Dedication	204,027	-	(240,000)	150,000	-	114,027
Development Charges	10,239,595	-	(780,000)	3,949,000	(3,501,548)	9,907,047
Federal Gas Tax	671,716	1,777,000	-	-	(1,777,000)	671,716
Ontario Community Infrastructure Fund (OCIF)	175,397	-	-	-	-	175,397
WEEDC - Economic Development	190,037	-	-	-	-	190,037
Building Services – Operating	1,538,641	-	(302,537)	-	-	1,236,104
Building Services – Capital	149,599	-		-	-	149,599
Tree Planting – Subdivisions	103,297	-	(20,000)	-	-	83,297
Parking Lot Development	704	-		-	-	704
	13,273,013	**1,777,000**	**(1,342,537)**	**4,099,000**	**(5,278,548)**	**12,527,928**
Discretionary Reserve Funds						
Future Employee Benefits	703,862	-	-	-	-	703,862
Debt Reduction	1,175,280	248,920	-	-	-	1,424,200
	1,879,142	**248,920**	**-**	**-**	**-**	**2,128,062**
Discretionary Reserve Funds – Wastewater						
Wastewater	2,376,023	1,340,416	(9,387,150)	-	3,477,000	(2,193,711)
Wastewater – Capital	996,830	271,600	-	-		1,268,430
	3,372,853	**1,612,016**	**(9,387,150)**	**-**	**3,477,000**	**(925,281)**
Discretionary Reserve Funds – Water						
Water	11,333,736	2,773,611	(3,945,367)	-	1,400,000	11,561,980
Water – Filters	977,016	103,000	-	-	-	1,080,016
Water Working Funds	1,061,541	-	-	-	-	1,061,541
Water – Contingency	319,172	-	-	-	-	319,172
Provincial Funding - OCLIF - Cannabis	34,952	-	-	-	-	34,952
Provincial Funding - MMAHO - Efficiency	631,700	-	-	-	-	631,700
	14,358,116	**2,876,611**	**(3,945,367)**	**-**	**1,400,000**	**14,689,360**

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Attachment #1

2021 Budget

Reserve and Reserve Funds

	Projected Opening Balance	Contributions	Operating and Capital Draws	Estimated Development Charges To Be Collected	Estimated Transfers between Funds	Projected Closing Balance
Reserves						
Working Funds	2,872,727	-	-	-	-	2,872,727
Contingency	880,669	-	(150,000)	-	-	730,669
Encumbrance	7,246,434	-	-	-	-	7,246,434
Community Improvement Plan	60,241	-	-	-	-	60,241
Assessment Stabilization	1,566,300	-	-	-	-	1,566,300
Accumulated Sick Leave	55,000	-	-	-	-	55,000
Employee Related	118,614	13,100	(35,000)	-	-	96,714
Self-Insuring	625,114	16,000	-	-	-	641,114
Community Benefit	1,137,290	239,640	(725,500)	-	-	651,430
Police Operating	129,821	54,300	(48,637)	-	-	135,484
Winter Control	373,996	-	-	-	-	373,996
Facilities – New	1,239,389	1,249,500	(1,400,000)	-	-	1,088,889
Facilities	2,167,020	972,800	(533,000)	-	-	2,606,820
Furniture and Fixtures	60,487	24,600	-	-	-	85,087
Vehicles & Equipment	800,555	603,500	(759,333)	-	-	644,722
Technology & Office Equipment	129,117	70,600	(95,100)	-	-	104,617
Technology Software	48,238	131,900	(106,500)	-	-	73,638
Fire Vehicles & Equipment	832,605	452,200	(150,000)	-	-	1,134,805
Roads	9,206,725	5,346,000	(2,930,000)	-	91,548	11,714,273
Railway Crossings	49,433	-	-	-	-	49,433
Bridges & Culverts	324,648	498,300	(45,000)	-	-	777,948
Storm water	1,454,483	834,600	(1,910,000)	-	-	379,083
Road Share of Drainage	948,483	378,700	-	-	-	1,327,183
Gravel Road Conversion	1,419,264	845,200	(40,000)	-	-	2,224,464
Street Lights – New	1,039,608	239,000	-	-	-	1,278,608
Playground Equipment	194,584	164,500	(157,000)	-	-	202,084
Trails – New	425,265	361,900	(75,000)	-	-	712,165
Trails – Existing	213,064	99,600	(20,000)	-	-	292,664
Parks Signage	30,900	10,300	-	-	-	41,200
Parks Furniture & Fixtures	41,987	225,000	(60,000)	-	-	206,987
Building Repairs & Maintenance	740,093	57,700	(65,000)	-	-	732,793
Election	71,356	35,000	(17,500)	-	-	88,856
Tree Replacement	58,130	-	(20,000)	-	-	38,130
Plans & Studies	653,953	319,500	(248,500)	-	310,000	1,034,953
Legal Reserve	96,623	-	-	-	-	96,623
Heritage Committee	-	5,000	-	-	-	5,000
	37,312,215	13,248,440	(9,591,070)	-	401,548	41,371,133
Total Reserves & Reserve Funds	70,195,340	19,762,987	(24,266,124)	4,099,000	-	69,791,203

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