Debt Management Policy

In 2013, the Financial Management Best Practice Committee (FMCBC) was reconvened to identify core financial best practices for municipalities in Nova Scotia. The Debt Management Policy was selected to be part of this group of essential best practices. The original recommended practice was developed by the Government Finance Officers Association (GFOA). Some aspects of the practice have been revised by the Financial Management Capacity Building Committee (FMCBC) for use by Nova Scotia municipal governments. The original GFOA recommended practice, *Analysing Debt Capacity and Establishing Debt Limits* (approved in June 2000), but was replaced by *Debt Management Policy* in 2003.

Recommendation

The GFOA recommends that municipalities should adopt comprehensive written debt management policies. The GFOA also recommends that municipalities should undertake an analysis of their debt capacity and establish realistic debt limits. Following the GFOA recommendation, the FMCBC recommends that prior to requesting financing from the Nova Scotia Municipal Finance Corporation (MFC), a municipality should carry out an analysis of its debt capacity.

Purpose

Municipalities should have their strategy and processes of how they choose to manage their debt and capital costs as a fixed document that can be accessed by all members of the municipalities (staff, Councillors, and residents). Furthermore, municipalities should conduct a comprehensive and routine analysis of debt capacity to provide assurance that the amount of debt acquired by a municipality is affordable and cost effective. A debt management policy, routinely analysing debt capacity, and establishing appropriate limits on debt issuance can help municipalities to keep their debt at affordable levels.

Background

When municipalities require capital financing, they enter into a long-term commitment with the MFC that requires them to make timely principal and interest payments over the life of the debt. Municipalities should ensure that:

- Future debt-service payments to the MFC can be made in full and on time, without jeopardizing the provision of essential services.
- An acceptable degree of flexibility, including sufficient revenues, to meet unanticipated expenditures and accommodate revenue fluctuations is preserved.
- Outstanding debt obligation will not threaten long-term financial stability.

- The amount of outstanding debt will not place undue burden on residents and businesses.

Considerations in Policy Development

When a municipality is analysing its debt capacity and establishing debt levels, there are a number of factors that should be taken into consideration. Some of the factors for consideration in analysing a municipality's debt capacity are listed below. For a more in-depth discussion of each factor, please refer to *Appendix I*.

1. Legislative limits affecting the amount of debt that can be issued.
2. Measures of the tax and revenue base.
3. Population trends.
4. Utilization trends for services underlying revenues.
5. Factors affecting tax collection.
6. Evaluation of trends relating to the municipality's financial performance.
7. Debt-service obligations.
8. Measure of debt burden on the community.
9. Market factors affecting interest costs.

Appendix II discusses the legislative and regulatory requirements surrounding a municipality's ability to borrow for capital projects. In addition to the legislative requirements surrounding borrowing requirements, SNSMR has developed a checklist for municipalities when they are seeking approval to borrow. *Appendix III* outlines the details of this checklist, the Temporary Borrowing Resolution Checklist. Furthermore, *Appendix IV* indicates the different types of municipal fees and user charges that municipalities have access to for revenue sources.

Appendices

Appendix I: Debt Capacity Analysis
Appendix II: Legislative Limits
Appendix III: Temporary Borrowing Resolution Checklist
Appendix IV: Municipal Fees and User Charges

Appendix I: Debt Capacity Analysis

The following is an in depth description of the kinds of analysis municipalities should conduct when determining if they can take on any more debt for capital projects.

1) *Legislative Limits*

Before a municipality can borrow from MFC, it must have approval from the Minister of SNSMR. As part of the approval process with SNSMR, a Temporary Borrowing Resolution Checklist needs to be completed to ensure that the municipality meets all the requirements for borrowing. A copy of the Temporary Borrowing Resolution Checklist can be found in Appendix C.

Municipalities should examine the following MGA components that they are required to adhere to:

- Borrowing for Operating Purposes–Section 84
- Borrowing for Capital Purposes–Section 86
- Requirements for Ministerial Approval–Sections 87 and 88

Each of these sections of the MGA can be found in *Appendix II*.

2) *Measures of Tax and Revenue Base*

Mandatory	*Secondary*
a) Property assessment information b) Ability to pay i) Unemployment ii) Average household income iii) Debt as a percentage of personal income	c) Inflation d) Real GDP

Mandatory Economic Variables

a) Property Assessment Information

Importance

Assessed property values are an important measure of a municipality's revenue base because they form the foundation of property taxes.

Indicator: Uniform Assessment per Dwelling Unit
This calculation produces an indicator that provides broad information on a municipality's ability to fund municipal services. A high uniform assessment per dwelling unit may indicate that the municipality is relatively well off compared to other municipalities. It is calculated by dividing uniform assessment by the total number of dwelling units.

Indicator: Change in Assessment
This indicator involves keeping track of both residential and commercial assessments. Each year the composition of the assessments in a municipality should be recorded to monitor the relative strength of each type of assessment. A downward trend in the proportion of commercial assessment could indicate an eroding economic base for the municipality.

b) Ability to Pay

i) Average Household Income

Importance
In addition to being used in tandem with assessed property values to determine the stability of the revenue base, the level of average household income in a municipality can also be used as a measure of capacity of the citizens to support the services provided by the municipality.

Indicator: Average Household Income
This indicates average household income that may be available (through taxes, user fees, or area rates) to pay for services in a municipality. A comparison across municipalities may indicate the relative economic well being of residents.

Indicator: Residential Tax Burden as a Percentage of Average Household Income
This is calculated by dividing the residential tax burden of a municipality by the average household income. It is another measure of the citizens' ability to pay property taxes.

ii) Unemployment

Importance
Unemployment levels serve as a further indicator of the ability of residents to pay property taxes and signal the economic strength of a municipality.

iii) Debt as a Percentage of Personal Income

Importance
This ratio is an indicator of the potential resources to repay debt; it indicates the

ability of the citizens to pay taxes in the event of a revenue shortfall.

Indicator: Residential Tax Burden/Average Household Income
This indicates the percentage of household income that is used to pay municipal property taxes. It is calculated by dividing residential tax burden by average household income. It expands on the Residential Tax Burden indicator to give a picture of the relative ability of taxpayers in a municipality to pay taxes.

Secondary Economic Variables

c) Inflation

Importance
Over time, inflation depreciates the purchasing power of a dollar. In order to compensate for this, investors will require a higher interest rate in periods of high inflation or future uncertainty.

d) Real GDP

Importance
Measuring the change in GDP provides information on the health and trend of the economy in general. This information may indicate potential changes in economic growth for a region and may have an impact on the municipality, either positive or negative. When measuring GDP, the most accurate measurement is real GDP in constant dollars, as this filters out the impact of inflation.

3) Population Trends

Importance
Population trends will affect the revenue base through their effect on property taxes. As the population in an area increases, so does the potential for an increase in the revenue base. As a municipality's population increases, the expenditures of the municipality may also increase. Municipalities should monitor its expenditures as well as its revenues when reviewing the results of a change in population.

Indicator: Change in Population
A change in population is calculated by taking the difference between population estimates of the current year and four years ago and dividing it by the current years estimated population. Continual decreases in population may indicate out migration, which can lead to structural problems in the economy of the municipality.

Indicator: Age Profile
This consists of three measures: the percentage of the population of a municipality that is 0-19 years of age; 20-65 years of age; and over 65 years of age. The three

percentages may indicate where expenditure pressures on a municipality will occur. For example, a young population may demand more playgrounds and ball fields, while an ageing population may want more resources invested in police services and walking trails.

Other demographic indicators

- Population density
- Net migration gain and loss
- Mobility

4) Utilization trends for services underlying revenues

Municipalities should consider the revenues generated from their non-tax and user fee sources when determining their total revenue sources. A list of all the non-tax user fees and charges that are applied by municipalities in Nova Scotia is located in Appendix IV.

5) Factors affecting tax collections

a) Types of Property

Importance
According to Section 26.1 of The Assessment Act, *all assessments shall be designated as being residential property, commercial property or resource property, or partly one and partly another*. It is important for municipalities to know the combination of its property in order to evaluate its revenue base.

Indicator: Commercial Assessment / Total Assessment
Commercial and total assessment can help indicate the relative strength of the municipality’s tax base. A higher percentage of commercial assessment indicates higher revenue-raising ability.

b) Tax Collection Risk

Importance
This indicator takes into account the fact that all taxes may not be collectable, and it measures the ability of a municipality to provide services from current ongoing revenues.

Indicator: Uncollected Taxes
This measure indicates the ability of taxpayers to pay their taxes on time. Uncollected taxes can also indicate the strength of current collection policies and the economic strength of a municipality. It is calculated by dividing total uncollected taxes at year-end by total tax levy.

Indicator: Valuation Allowance
The size of the valuation allowance is representative of the amount of taxes (and other accounts receivable) that may be uncollected by a municipality.

6) *Evaluating Trends Relating to the Municipality's Financial Performance*

a) Revenues and Expenditures

Importance
Municipalities should evaluate the accuracy of their budgets against actual results, including both revenue and expenditure projections. The evaluation will indicate any changes in revenues and expenditures, and if revenues and expenditures are changing in tandem or not. Evaluating the trends can also help municipalities predict revenue and expenditure behaviours, which will assist in determining how much debt a municipality can afford to carry.

Indicator: Trend Analysis
The following steps should be undertaken when conducting a trend analysis

1) Forecast revenues and expenditures for three to five years based on past revenue and expenditure growth trends, plus any known changes.
2) Calculate the change in revenues each year over the previous year: (Current Revenue – Previous Year Revenue) / Last Year Revenue
3) Use the same calculation for expenditures.
4) Compare the changes and note whether or not a gap exists between the rate of change in revenues and in expenditures.

b) Fund Balance Levels

Importance
Unreserved fund balances have a number of benefits for a municipality. An unreserved fund balance provides a cushion that allows a municipality to absorb short-term swings in its revenues or expenditures, without having to increase taxes or cut services to react to the swing. Unreserved fund balances may also be used to fund a portion of the capital cost of a capital asset. (See FMCBC's recommended practice *Appropriate Level of Operating Reserves and Accumulated Surplus* for a deeper discussion.)

7) *Debt-Service Obligations*

a) Existing and Potential Debt-Service Requirements

Importance
It is important to know how much debt servicing a municipality is already committed to before more debt can be taken. The level of debt that a municipality can carry is

influenced by a number of factors:

- SNSMR have guidelines recommending a limit of 15% on a municipality's debt-service ratio. According to provincial policy, municipalities should not borrow if the proposed borrowing would put their debt service ratio above 30%. SNSMR also has guidelines recommending a limit of 3.5% on a municipality's debt-to-uniform-assessment ratio. According to provincial policy municipalities should not borrow if the proposed borrowing would put their debt-to-uniform-assessment ratio above 7%.

- The state of a municipality's infrastructure will also influence its debt levels and debt-servicing costs.
    - A municipality that is experiencing growth may be required to invest in infrastructure, which will increase its debt-servicing costs compared to another municipality.
- Debt-service payments are fixed and must be paid each year.
    - Revenues such as a one-time grant or extraordinary gains from the sale of an asset are discretionary.
    - Discretionary revenues should not be counted when determining if adequate revenues exist to pay the debt-service, as they may not be available next year.

Indicator: Trend Analysis
Municipalities should look at all existing debt and debt-servicing costs. Based on the municipality's capital budget, forecast what the debt-servicing costs are likely to be over the next three to five years. Assumptions will have to be made based on the interest rates for future commitments.

b) Debt-Service as a Percentage of Own-Source Revenue

Importance
A high debt service ratio may indicate that a municipality has taken on too much debt, or it may indicate that the municipality has taken an aggressive approach to repaying their debt to avoid interest costs. Similarly, a low debt-service ratio could indicate that a municipality is strong financially or has chosen to finance some capital projects through their operating budget. However, a low debt-service ratio may also indicate that a municipality is financially weaker, and that it has deferred capital projects by allowing important infrastructures to deteriorate.

Indicator: Debt-Service Ratio
The debt-service ratio indicates the amount of own-source revenue that is being used to service the municipality's debt. A high debt-servicing ratio indicates that there is less revenue available for providing services. The debt-service ratio is calculated by dividing total long-term debt-servicing costs – which should include lease payments, temporary financing, and other debt charges, and then divide those totals by the total own-source revenue.

8) *Measure of debt burden on the community*

a) Debt per Capita

Importance
Debt per capita indicates how much debt the municipality owes per person. It represents how much each resident will have to contribute in taxes to pay down the debt. Debt per capita is a useful for municipalities to compare municipalities of similar population sizes.

Indicator: Residential Tax Burden
Comparing residential tax burdens among municipalities is a more accurate reflection of a municipality's financial health rather than comparing property tax rates. A high residential tax burden may indicate that a municipality is reaching a ceiling on tax rates, or that it does not have a strong commercial tax base. A low residential tax burden may indicate that a municipality has a relatively large commercial tax base to share the tax burden.

9) *Market factors affecting debt servicing costs*

a) Interest Rates

Importance
Interest costs are affected by the interest rates and length of borrowing. Depending on the economy, interest rates can significantly affect the interest costs. Also, the longer the time for financing, the higher the interest cost. This will usually occur because investors require a premium for investing their money for an extended period of time.

b) Inflation

Importance
Inflation will also affect interest costs. In times of rising inflation, interest costs will be higher because future dollars will be worth less than current dollars. Investors will want to offset their lower purchasing power by ensuring that they receive a higher return (interest) on their investment. When determining the cost of borrowing, projections are made on both the anticipated interest rates and inflation rates.

Appendix II: Legislative Limits

The following are legislative components that municipalities should be aware of when considering financing capital projects. The following legislative components are all from the MGA. All of these sections of the MGA can be found at: http://nslegislature.ca/legc/statutes/municipal%20government.pdf.

Borrowing for Operating Purposes

Borrowing Limits

84 A municipality may borrow to cover the annual current expenditure of the municipality that has been authorized by the council, but the borrowing shall not exceed fifty per cent of the combined total of the taxes levied by the municipality for the previous fiscal year and the amounts received, or to be received, by the municipality from Her Majesty in right of Canada or in right of the Province or from an agency of Her Majesty.

Borrowing for Capital Purposes

Minister may establish borrowing limits

86 **(1)** The Minister may in each fiscal year, establish borrowing limits for a municipality, village or service commission.

(2) Where borrowing limits are established, a municipality, village or service commission may not borrow money pursuant to this Act of the Legislature, unless the proposed borrowing is within the limits established.

(2) Subsection (1) and (2) do not apply to borrowing for the purpose of defraying part of the annual current expenditure of a municipality, village or service commission.

Requirements for Ministerial Approval

Capital Budget Filing

87 The Minister shall not establish borrowing limits or approve a borrowing resolution for a municipality, village or service commission in a fiscal year unless the municipality, village or service commission, as the case may be, has filed with the Minister its capital budget for the fiscal year in the form prescribed by the Minister.

Ministerial Approval

88 **(1)** No money shall be borrowed by a municipality, village, committee created by an intermunicipal agreement or service commission pursuant to the provision of this Act or another Act of the Legislature until the proposed borrowing has been approved by the Minister.

(2) Subsection (1) and subsection 438 (2) do not apply to a borrowing for the purpose of defraying part of the annual current expenditure of a municipality, village or service commission.

(3) A guarantee by, or on behalf of, a municipality, village or service commission of a borrowing or debenture is not effective unless the Minster has approved of the proposed guarantee.

(4) A municipality may enter into a lease, lease-purchase or other commitment to pay money over a period extending beyond the end of the current fiscal year, provided that where the total commitment exceeds one hundred thousand dollars, the proposed commitment has been approved by the Minister.

(5) Subsection (4) does not apply to an employment contract or collective agreement.

Appendix III: Temporary Borrowing Resolution Checklist

The following information is required for the SNSMR Temporary Borrowing Resolution Checklist that is included with the recommendation for the Minister to approve municipal borrowing resolutions.

Debt-Service Ratio

The debt-service ratio is measured as total debt service costs including interest and principal payments divided by own source revenue, which is total revenue less transfers. Under current guidelines, borrowing resolutions can be approved for municipalities with debt-service cost to own-source revenue of 15%. All borrowings that would result in a debt-service ratio above 15% require greater scrutiny and may be approved depending on circumstances.

Three-Year Capital Budget

As mentioned in *Section 87* of the MGA, a municipality must file its three-year capital budget before the Minister will approve any borrowing resolutions or impose any borrowing limitations.

Municipal Purpose

The municipality must disclose the purpose for the borrowing. *Section 65* of the MGA outlines all the purposes that a municipality can classify a purpose for borrowing.

Is it a Capital Purpose?

A municipality is not authorized to issue long-term debt for operating expenses. All borrowing must be for capital purposes. The other items that need to be disclosed when applying for a borrowing resolution approval are:

- The useful life of the capital asset;
- The total project cost; and
- The cost-sharing arrangements and their terms.

Appendix IV: Municipal Fees and User Charges

The following table describes the different types of municipal fees and charges municipalities can use to indicate their revenue sources.

Zoning Control Fees	Fee Rates
Development Agreement/Amendment	Flat Rate + Advertising Costs
Development Permit	Flat Rate
LUB (only) Amendment	Flat Rate + Advertising Costs
MPS (only) Amendment	Flat Rate + Advertising Costs
Subdivision Processing	Flat Rate + Advertising Costs
Variances	Flat Rate + Advertising Costs

Building Permit Fees	Fee Rates
Construction/Locating a Swimming Pool (Including Fence)	Flat Rate
Demolition Permit (Building or Structure)	Flat Rate
Location/Relocation of an Existing Structure or Mobile Home	Flat Rate
New Construction/Additions (Commercial, Industrial, Other Buildings, Not Specified)	Flat Rate + $ per Square Foot
New Construction/Additions (Resdential, Cottages, Churches)	Flat Rate + $ per Square Foot
New Construction/Additions (Sheds, Decks, Shell Storage Buildings, Garages, Barns, Forestry/Fishing Buildings Not for Human Occupancy)	Flat Rate + $ per Square Foot
Renewel of an Approved Permit	Flat Rate
Repairs, Renovations/Alterations to All Existing Buildings	Flat Rate + $ per $1000
To Amend a Permit in Force	Flat Rate

Fees for Services	Fee Rates
Building Permits (Residential, Commercial/Industrial)	Flat Rate
Bylaw Copies	$ per Copy plus tax
Detailed Property History Letters	Flat Rate
Dogs (License/Registration, Boarding, Impounding)	Flat Rate
Faxes (Outgoing, Incoming)	Flat Rate
General Research	$ per Hour
Mobile Homes (License, License Replacement, Park License)	Flat Rate
MPS/LUB Plan Package	Flat Rate + Delivery Costs
National Building Code	Flat Rate
NSF Cheques	Flat Rate
Parking Fines	Flat Rate
Photocopies	Flat Rate
Public Market (Daily, weekly)	Flat Rate
Recreation Program (Registration)	$ per Registrant
Sewer User Charge	Flat rate or linked to water/effluen
Subdivision By-law	Flat Rate + Delivery Costs
Supply Maps/Prints	$ per Copy
Tax Certificates	Flat Rate
Taxi (Owner's License, Operators License)	Flat Rate
Vending (Door-to-door, Stand)	Flat Rate
Zoning Confirmation Letters	Flat Rate

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Nova Scotia. Assessment Act. R.S.N.S. 1989, Chapter 23. Section 26-1, "Classification of Property". http://nslegislature.ca/legc/statutes/assessment.pdf

Nova Scotia. Municipal Government Act. Part 4–Finance Section 4, "Borrowing Limits", Section 86 "Minister May Establish Borrowing Limits", Section 87 "Capital Budget Filling" and Section 88 "Ministerial Approval". http://nslegislature.ca/legc/statutes/municipal%20government.pdf

Nova Scotia Department of Finance: Economics & Statistics. Employment, Unemployment, Participation Rates, Forecasts, Labour Force Characteristics, by Economic Region. http://www.gov.ns.ca/finance/statistics/agency/index.asp

Public Sector Accounting Board, The Canadian Institute of Chartered Accountants. CICA Public Sector Accounting Handbook.

Property Valuation Services Corporation. http://www.pvsc.ca

Province of Nova Scotia Service Nova Scotia and Municipal Relations. Municipal Indicators. http://www.gov.ns.ca/snsmr/municipal/finance/indicators.aspStatistics Canada. Community Profiles. http://www12.statcan.ca/english/profil01/PlaceSearchForm1.cfm

Statistics Canada. Communication, Transportation and Trade: Trade. http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/ind01/l3_2256-eng.htm?hili_none

Statistics Canada. Population. http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/ind01/l3_3867-eng.htm?hili_none

Statistics Canada. Manufacturing and Construction: Manufacturing.
http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/manuf10-eng.htm
Statistics Canada–CANSIM II. Labour–Unemployment; Prices and Price indexes Inflation; Trade: Retail trade; and National Accounts: Gross Domestic Product.
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