Where do we go from here? A Financial Perspective

Presentation to

MFOA / LAS Symposium

Bill Hughes

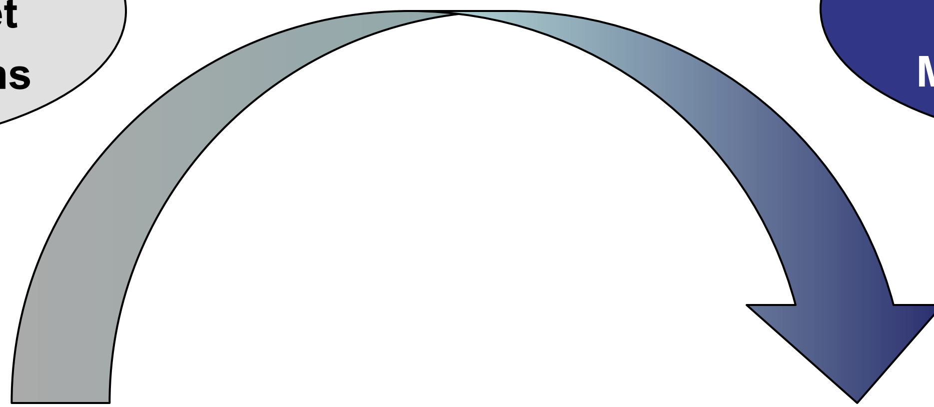
March 26, 2014

Outline

- Financial Sustainability and Asset Management
- A Conceptual Framework
- Fiscal Strategy
- A Few Examples

What is our starting point?

Early Stage,
Preliminary Asset
Management Plans



Advanced,
Detailed Asset
Management Plans

PSAB 3150 CAPITAL ASSET INVENTORY DATA:

- Historic Cost
- Amortization
- Accounting Useful Life

FULL CAPITAL ASSET LIFECYCLE COSTING DATA:

- Ongoing Maintenance Costs
- Major Rehab Costs
- Full Replacement Costs

Dramatic shift in responsibility for infrastructure

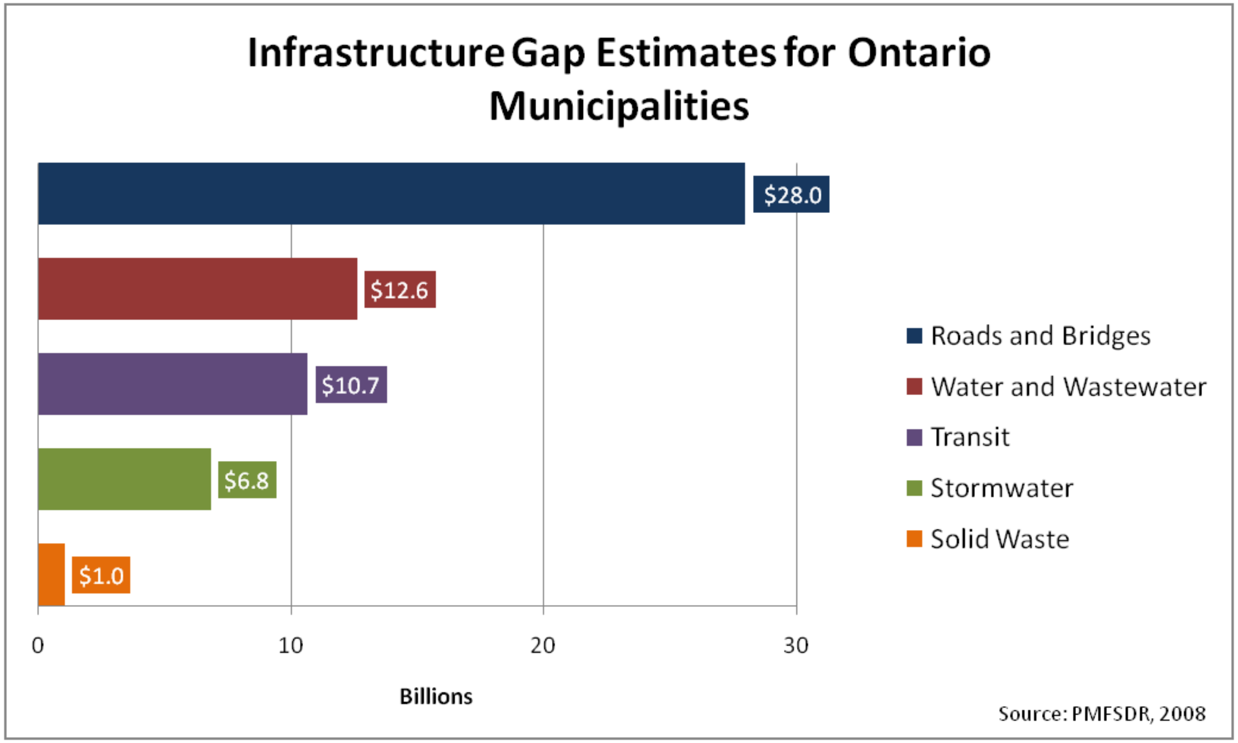
- The municipal share of asset ownership in Ontario has significantly increased since the 1960's

Share (%)	1961	2005
Federal	31%	10%
Provincial	31%	22%
Local	38%	67%

Original source: StatsCan, From Roads to Rinks, Table A.1, Feb. 2008

Municipal Infrastructure Gap

- The municipal infrastructure gap in Ontario has been estimated at nearly $60 billion

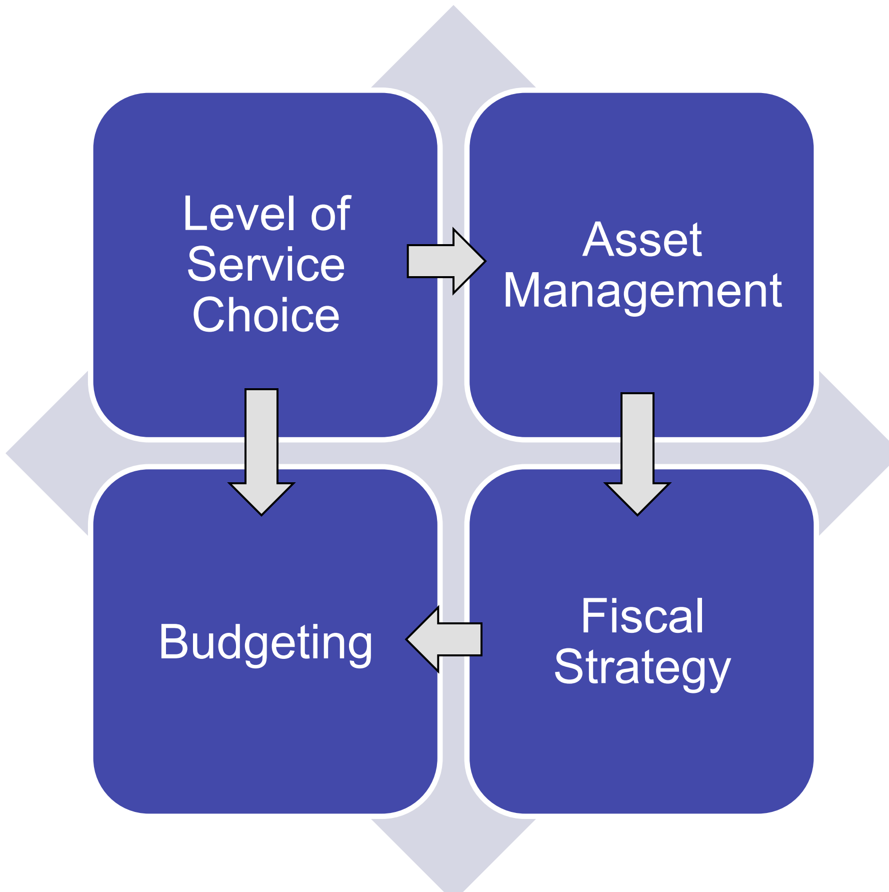


Source: Towards a new federal long-term infrastructure plan, AMO 2012

Long-Term Financial Sustainability Challenge

- Financial sustainability requires long-term planning; it does not just happen
- The two biggest threats to long-term financial sustainability are:
  - The cost of infrastructure investments (asset management)
  - A potential mismatch between level of service decisions and economic reality

Asset Management has Profound Financial Implications



Figuring Out Where to Start

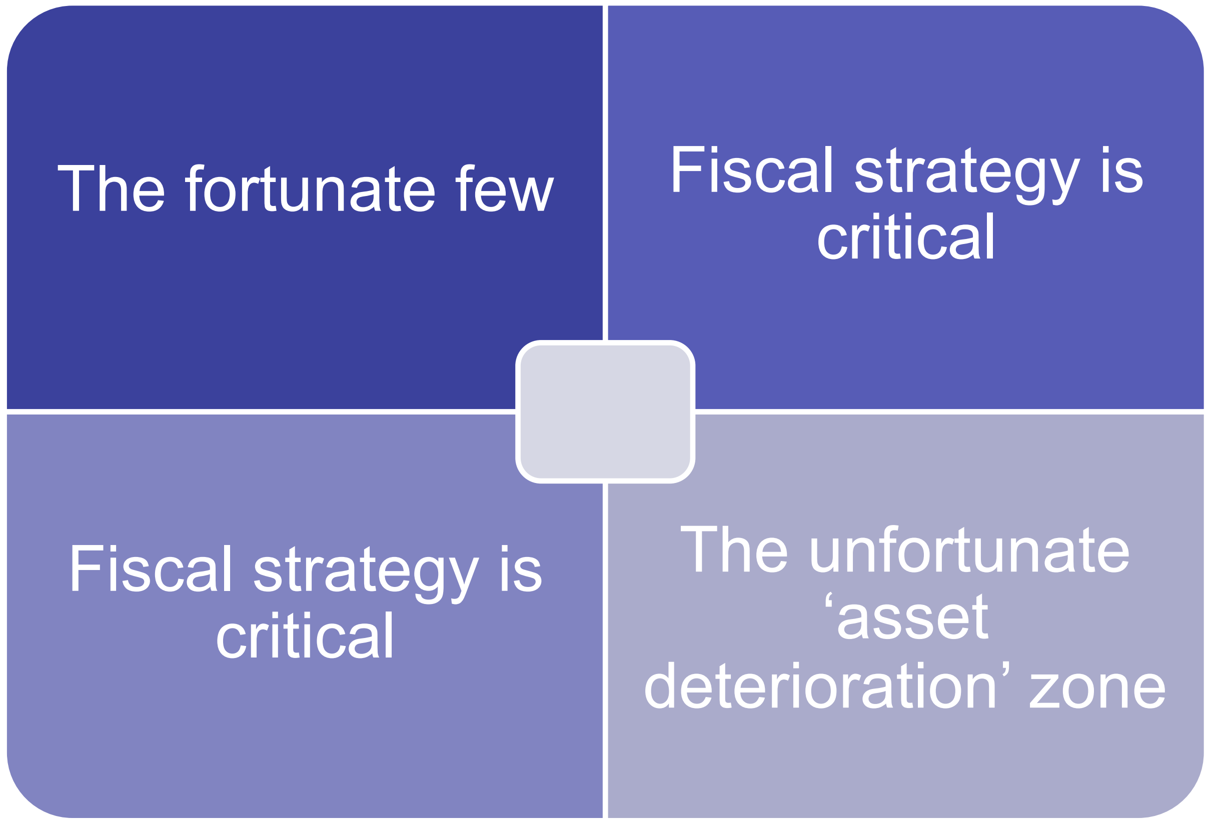
- At least four key factors influence how a municipality should think about how it will pay for its asset management plan:
  - Fiscal capacity
  - Infrastructure intensity
  - Investment timing
  - Inter-generational equity considerations

Fiscal capacity and infrastructure intensity affect needs and solutions

Fiscal Capacity

Growing municipality / high capacity

Stable / declining municipality; moderate to weak fiscal capacity

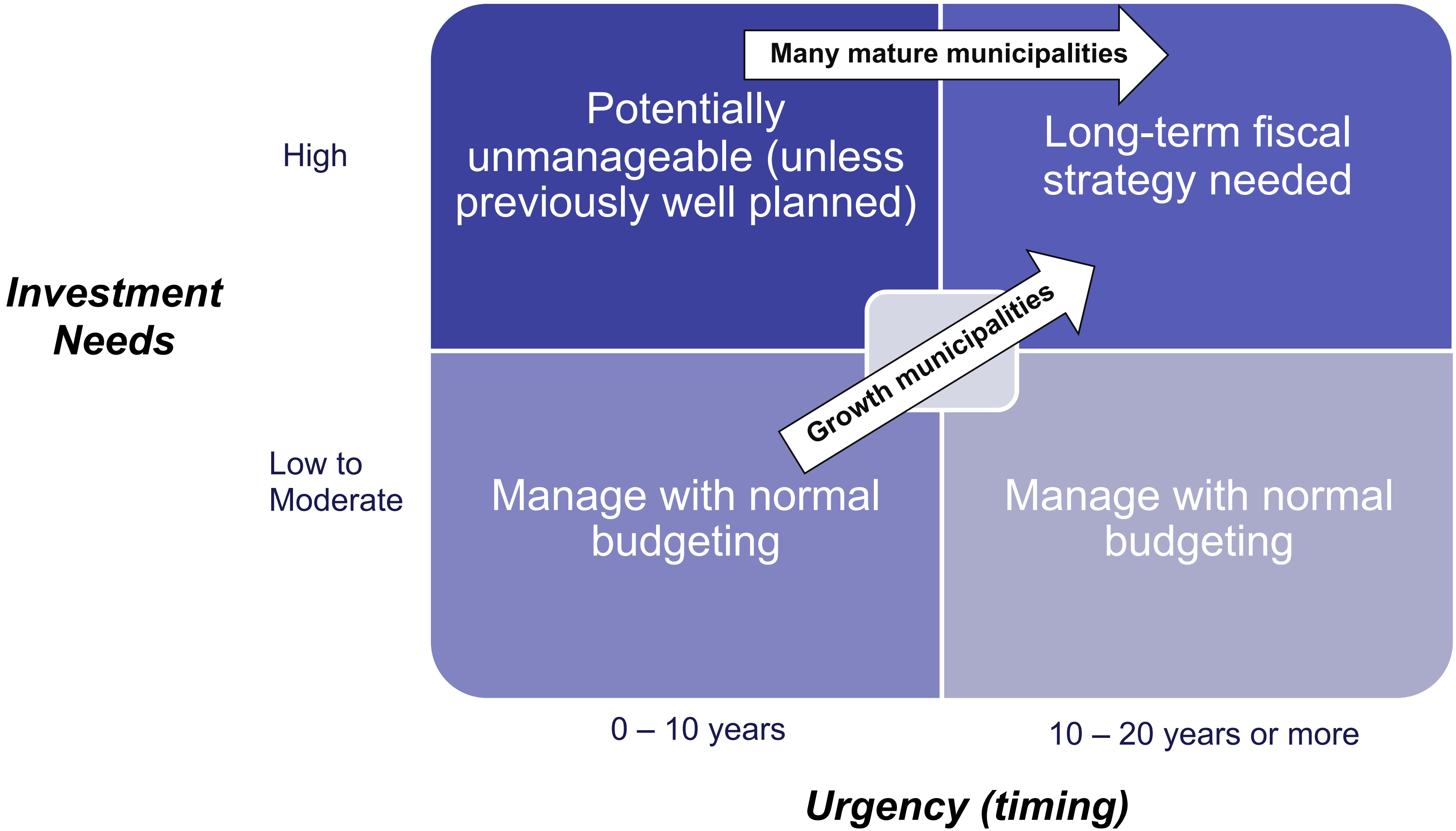


Low to moderate infrastructure per capita

High infrastructure per capita

Infrastructure Intensity

…so does the absolute level of investment needs and their urgency



The Elements of Fiscal Strategy

- For the purposes of today's discussion, fiscal strategy refers to the interaction between the capital plan, debt management, reserve management and the budget (tax levy and rate supported)

- A municipality's ability to deliver on its asset management plan depends on the quality of its fiscal strategy

Managing the Capital Plan

- The capital planning process identifies capital needs, including asset management needs, and aligns them with the fiscal strategy
- The interplay between capital planning, reserve management and debt management can change the size of the capital plan and the timing of particular projects
- Plans should take a long-term view and be based on best-available information, but should be nimble and adaptable to adjust to new information and changing priorities

Reserve Management

- The prudent use of reserves is fundamental to the implementation of asset management plans
- Reserves hold several benefits over other funding sources
  - They reduce the need to issue debt or access in-year tax levy funding
  - By avoiding debt, financing costs are reduced
  - Contributions to reserves can be ‘smoothed’ to provide a predictable impact on the tax levy and water and wastewater rates
- Reserves can be built through planned contributions or through the use of operating surplus (and other) policies

Debt Management

- Debt will remain a financing source for many municipalities
- Proponents of debt financing argue that it spreads the cost of assets over a longer portion of their useful lives
- Opponents argue that debt servicing payments reduce fiscal room and crowd out other spending
- Debt room should be preserved to maintain flexibility in financing long-term capital asset needs
- Debt should not be the primary source for repair and replacement projects

Inter-Generational Equity

- Good planning means that the people who benefit from an asset are also the ones who pay for it
- Several sources suggest that the children of baby boomers will be the first to have lower life-time income than their parents
- If this is the case, it may be prudent to save more today for future investment in asset management than current consumption of assets would suggest

Example 1 – Growth

Municipal Situation:	Fiscal Strategy:
Growing, with a high fiscal capacity	Pay as you go for capital repair and maintenance
Mostly new infrastructure	Manage capital plan
Asset management investments largely in the future	Eliminate tax levy debt
Either high or low infrastructure intensity	Aggressively build asset rehabilitation and repair reserves

Example 2 – Mature and High Needs

Municipal Situation:

- Mature state
- Moderate to high fiscal capacity
- Large infrastructure investment needs now and in the future

Fiscal Strategy:

- Draw down existing reserves for current asset management needs, where possible
- Issue debt where reserves are inadequate
- Shift capital plan towards asset management investments
- Increase taxes and user rates as rapidly as possible to service debt and build reserves for future needs

Example 3 – Mature and Lower Needs

Municipal Situation:

- Mature state
- Low fiscal capacity
- Low to moderate infrastructure investment needs now and in the future

Fiscal Strategy:

- Carefully manage capital plan
- Minimal tax levy or rate-supported debt
- Ensure reserve contributions match smoothed needs
- No complicated strategy needed

Example 4 – Low Capacity, High Needs

Municipal Situation:

- Mature state
- Low fiscal capacity
- High infrastructure investment needs now and in the future

Fiscal Strategy:

- Curtail new capital investment and consider decommissioning assets (lower level of service)
- No tax levy or rate-supported debt
- Little reserve potential
- Focus on securing federal and provincial transfers (ongoing and new)

Conclusion

- Asset management is simultaneously one of the greatest challenges to financial sustainability and essential to achieving it
- The time to consciously plan for financial sustainability in relation to asset management is now
- A comprehensive fiscal strategy will be needed in most cases, consisting of an interplay between the long-term capital plan, debt management, reserve management and the budget
- The nature of the fiscal strategy that a municipality should pursue is contingent on its own situation, although general principles can be applied