POLICY ON THE MANAGEMENT OF LONG-TERM DEBT AND ACCUMULATED SURPLUSES

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PREAMBLE

1° The Municipal Council and all the administrators of the Municipality of Chelsea must prioritize the financial management of the Municipality's affairs. The Policy on the Management of Long-term Debt and Accumulated Surpluses is an essential tool for managing the Municipality's debt and ensuring it has sufficient reserves to deal with exceptional or unforeseen situations.

2° Long-term debt management implies that the level of debt carried is reasonable, that it is commensurate with the taxpayers' ability to pay, and that it allows the Municipality to maintain quality services for residents while also being able to capitalize on development opportunities.

4° Recourse to debt financing should be used with caution because it impacts the taxes of future generations and limits the Municipality's ability to adapt to new responsibilities or unforeseen circumstances.

5° The purpose of long-term debt management is to establish rules on how to make decisions related to debt so as to maintain a sound financial position. The policy formalizes the decision-making process for the annual budget, the three-year capital assets plan, and any investment project that may affect how much debt the Municipality carries.

6° Accumulated surplus management ensures that the Municipality has sufficient financial reserves to avoid operating deficits in the event of unforeseen and exceptional situations and the ability to stabilize certain tax burdens to avoid major variations in annual property taxes.

7° The purpose of accumulated surplus management is to establish rules for how to make decisions related to accumulated surpluses so the Municipality can by prepared for any eventuality. The policy will improve the decision-making process for setting the annual budget and planning investment projects that could be financed in part or in full by accumulated surpluses earmarked for this purpose.

1. POLICY OBJECTIVES

1° The objectives of the Municipality of Chelsea's Policy on the Management of Long-term Debt are as follows:

a. Establish a framework to monitor the level of debt owed by all taxpayers in the Municipality and set limits based on the ratios determined in Section 4.2;
b. Adopt management practices to limit the growth of the debt borne by all taxpayers;
c. Optimize the use of financial resources while respecting the principle of intergenerational equity;
d. Ensure the Municipality has the capacity to provide residents with quality services;
e. Track any changes in the level of debt borne by all taxpayers to ensure sound management and better predict the medium- and long-term impact on debt servicing and taxation in future years;
f. Ensure that management and planning are transparent and accessible to residents;

g. Develop a balanced funding strategy;
h. Decrease long-term debt (Once major investments are completed in 2023 or 2024).

2° The objectives of the Municipality of Chelsea's Policy on the Management of Accumulated Surpluses are as follows:

a. Establish a framework to monitor the surpluses accumulated by the Municipality and set limits based on the ratios determined in Section 5.2;
b. Properly manage the Municipality's finances so that it has the necessary leeway to deal with exceptional or unforeseen situations;
c. Ensure the Municipality's financial stability by levelling certain expenditures that can vary significantly from year to year;
d. Avoid abruptly reducing the level of services provided to residents;
e. Ensure a balanced budget;
f. Finance investment projects to limit the need for loans;
g. Define the mechanisms for creating, allocating, and using accumulated surpluses.

2. OBSERVATION

Since 2013, the Municipality of Chelsea has undertaken extensive infrastructure upgrades and has had to invest significant amounts in major projects, including upgrading the water and wastewater network in the centre of town and repairing a number of municipal roads. This major investment cycle is expected to end in 2023 or 2024, when the Municipality's debt level will be at its highest.

3. LEGAL FRAMEWORK

The Municipality of Chelsea must comply with the *Municipal Code of Québec* (R.S.Q., chapter C-27.1) and the *Act respecting municipal debts and loans* (R.S.Q., chapter D-7), which establish certain rules and obligations with respect to long-term financing. These laws specify the categories of loans that the Municipality can take out and the processes for doing so. The Municipality may borrow money by issuing bonds, notes, or any other securities (R.S.Q., chapter C-27.1, section 1060.1).

The Municipality must auction the bonds based on written submissions through a procedure carried out in collaboration with Ministère des Affaires municipales et de l'Habitation.

4. LONG-TERM DEBT MANAGEMENT PRACTICES

To achieve the objectives set by the Policy on the Management of Long-term Debt, the Municipality has adopted various management practices. These practices guide municipal authorities and administrators by establishing maximum target indicators for the long-term debt borne by all taxpayers in the municipality and guidelines for capital financing and debt repayment.

4.1 Define the content of the debt to be borne by all taxpayers (hereinafter referred to as "the debt")

1° The Municipality would like to track the growth of debt, the burden of which falls to all of its taxpayers. It will therefore exclude:

a. The accumulated surplus allocated to the repayment of long-term debt;
b. The debt assumed by the Government of Québec;
c. The debt assumed by the Government of Canada;
d. The debt assumed by a portion of taxpayers (local improvement taxes, etc.);

e. The debt assumed by third parties;
f. The debt assumed by municipal bodies;
g. The balance of closed loan settlements allocated to the repayment of long-term debt.

4.2 Establish benchmarks to measure the level of municipal debt

1° This practice makes it possible to establish checkpoints and keep loans at acceptable levels.

2° The following benchmarks and targets have been selected:

a. The ratio of debt service to total taxpayer burden

$$\frac{\text{Debt service borne by all taxpayers}}{\text{Operating expenses + capital repayment}}$$

- Maximum ratio: 17%
- Target: 15% and under

b. Debt to be borne by all taxpayers based on standardized property wealth (SPW)

$$\frac{\text{Debt borne by all taxpayers}}{\text{SPW}}$$

- Maximum ratio: 2.5%
- Target: 2% and under

3° Derogation clauses

a. The Municipality may deviate from the ratios mentioned in the following situations:

- Payment of significant operating expenses arising from a judgment;
- Loans to satisfy a judgment;
- Special situations that affect the Municipality’s property values.

b. The derogation should then be limited to the direct impact these causes have on the calculation of the ratios.

c. In these cases, the Municipality will implement a process to review this policy and establish a way to monitor and achieve new target ratios set according to the situation.

5. ACCUMULATED SURPLUS MANAGEMENT PRACTICES

To achieve the objectives of the Policy for the Management of Accumulated Surpluses, the Municipality has adopted a number of management practices.

These practices guide how municipal authorities and administrators deal with unforeseen events, higher than expected costs, and funding for capital expenditures.

5.1 Management practice for accumulated surpluses

1° Prudent management dictates that the Municipality should maintain a minimum amount of money in its unrestricted operating surplus to deal with exceptional or unforeseen situations.

It should also create and maintain funds in operating surpluses allocated for specific purposes.

2° The Municipal Council can pass a resolution to create “allocated operating surpluses” out of the unrestricted operating surplus, making sure to specify why the allocated operating surpluses have been created and how they should be used.

3° After the annual financial statements have been filed, the Municipal Council will proceed as follows:

a. It will create allocated operating surpluses using leftover budgetary funds for particular expenses that have not been fully paid at the end of the fiscal year.

b. It will maintain a minimum amount of its current budget as an unrestricted operating surplus as per the benchmarks and targets in Section 5.2.

c. It will set aside an amount for early debt repayment or for an “allocated operating surplus for long-term debt buyback”[1] that corresponds to:

- A minimum of 25% of the recorded annual operating surplus;

<u>or, if it is less:</u>

- The remaining amount after applying the above rules.

[1] “Allocated operating surplus for long-term debt buyback” refers to accumulating sums to pay off a loan or repurchase capital debt already accrued pending the maturity dates for repurchasing such debt.

d. It will create or replenish an operating surplus to be used for the cash payment of capital assets.

e. It will create or replenish other allocated operating surpluses as it deems appropriate.

5.2 Establish benchmarks to measure the level of unrestricted operating surpluses

1° This practice establishes checkpoints to make sure unrestricted operating surpluses are kept at acceptable levels.

2° The following benchmarks and targets have been selected:

a. The ratio of unrestricted operating surplus to annual budget

$$\frac{\text{Unrestricted operating surplus}}{\text{Total annual budget}}$$

 Minimum ratio: 3.5%
 Target: 5%

3° Derogation clauses

a. The Municipality may deviate from the ratios mentioned in the following situations:

- Payment of significant operating expenses arising from a judgment;
- Special situations that affect the Municipality's property values.

b. The derogation should then be limited to the direct impact these causes have on the calculation of the ratios.

c. In these cases, the Municipality will implement a process to review this policy and establish a way to monitor and achieve new target ratios set according to the situation.

6. STRATEGY FOR MANAGING THE LEVEL OF DEBT AND ACCUMULATED SURPLUSES TO ACHIEVE TARGETS

1° Once the annual financial statements have been filed, diligently apply the rules governing the use of operating surpluses as described in Section 5.1.

2° Oversee studies and analyses, the determination of investment budgets, and the adoption of the three-year capital assets plan in accordance with the practices set out in this Policy.

3° Globally respect the annual net amounts adopted under the three-year capital assets plan. If there are any unplanned investments, other planned projects of equal net value will have to be cancelled or postponed and vice versa.

4° Gradually build up a fund for the “cash payment of assets.” The fund should equal the higher of the following two amounts:

- 1% of the operating budget;
- The amount equivalent to 100% of the payroll (including fringe benefits) of permanent employees transferred in loan settlements.

5° Use the surplus allocated to repay debt on a priority basis:

a. To repurchase and fund settlements related to operating expenses;
b. To repurchase and fund settlements related to capital assets that are no longer assets of the Municipality;
c. To buy back debt for amounts less than $10,000;
d. To repurchase and fund settlements related to studies, plans, and other items of this nature;
e. To repurchase and fund settlements for terms of five years or less.

6° Make sure that enough budgetary funds have been allocated to avoid long-term financing of operating expenses that would saddle future generations with current operating expenses.

7. ESTABLISH RULES AND STRATEGIES FOR SELECTING INVESTMENT FINANCING MODELS

1° The Municipality must try to maintain a balance between expenses financed over the long term and the duration of the services the expenses pay for.

2° Since recourse to debt spreads the tax burden out over future fiscal years, the Municipality needs to be aware that expenditures financed this way will be used for at least as long as the useful life of services provided to residents. It’s a simple way to maintain intergenerational balance, i.e., to make the generations that will benefit from the investments pay for them. The board intends to:

a. Finance its capital expenditures over a period not exceeding their foreseeable life without major upgrades or intervention. See the following chart:

Infrastructure Work	
Minor repairs, water connection renewals, etc.	10 years
New construction or major upgrades	20 years
With local improvement tax (LIT)	20 years
Buildings	
Minor repairs, new partitions, etc.	10 years
New construction or major upgrades	20 years

Purchase of land (for resale)	10 years
Sports fields (includes play structures)	10 years
Machinery and equipment	
Fire trucks	15 years
Heavy trucks	10 years
Vehicles (including vans)	5 years
Office or computer equipment	5 years
Plan and specifications/professional fees	5 years
Non-capital expenditures	5 years
Subsidized program	
Capitalizable municipal share	According to the specific category
Government share	According to protocol

b. Maximize the use of its working capital to finance capital assets, with emphasis on capital assets:

- Under $50,000;
- With a life expectancy of 10 years or less.

c. Maximize the use of the fund for the cash payment of assets to finance:

- Capital projects with an average unit cost of less than $25,000;
- Investment projects with a short average useful life (5 years or less).

8. ACCOUNTABILITY

1° The Finance Department is responsible for implementing, monitoring, and evaluating the guidelines set out in the Policy on the Management of Long-term Debt and Accumulated Surpluses.

2° The Municipal Council will require the Finance Department to submit the following each year, within 45 days of the issue of fall bonds:

- A report evaluating its total (unconsolidated) debt and the debt borne by all taxpayers over the last five years as well as a projection of their potential growth over the next five years;
- A report containing the reference ratios set out in Sections 4.2 and 5.2 for the last

five years and a projection of their potential growth over the next five years;
- A statement of the assumptions used to establish the projections for the next five years.

9. FINAL PROVISIONS

This policy takes effect upon its adoption by Council.[2]

[2] Policy adopted by Council on August 4, 2020, Resolution 230-20