POLICY FS-19: Capital Financing Policy

Financial Services

Approval Date: **December 8, 2009**
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Revision Date/s:

Purpose:

The purpose of this policy is to establish financing principals for the funding of capital expenditures. Norfolk County Council has adopted a corporate strategic plan and one of the directives of the plan is to pursue financial sustainability. This policy has been created to promote sustainability in the capital funding program.

Implementation Procedure:

This policy outlines the principles related to the financing of capital expenditures. In order to maintain a sustainable financial program the financing of capital expenditures needs to be clearly laid out and understood. This policy will outline a variety of capital expenditures and recommend a number of alternatives to consider in financing them.

There are two basic types of capital expenditures:

1. Replacement
2. New

Replacement expenditures relate to the costs associated with the replacement of currently used assets with a replacement asset of substantially the same type or nature. An example would be the replacement of a used 1/2 ton pickup truck with a new ½ ton pickup truck - the replacement of an asset with a similar asset.

A new asset expenditure relates to the purchase of a new asset where no asset has been in place before. To continue with the above example, it would relate to the purchase of an additional ½ ton pickup where no pick up existed before – an additional truck (new staff, new service, etc).

In some cases when replacing assets there may be a need to enhance or add to the asset. In these circumstances there is a replacement portion and an enhanced/expanded portion. A determination needs to be made prior to replacement as to the degree and nature of the enhancement. It may be due to new cost cutting technology, it may be related to health and safety or it may be related to expanded services related to growth. Once again, to consider our example, the replacement pick up may have fuel saving technology, it may have new and improved safety features or it may be required because we have more roadways to maintain. These sorts of changes will require analysis and determination of appropriate funding. These expenditures may include a range of financing.

CAPITAL FINANCING TOOLS:

Various tools available for the financing of capital expenditures are set out below. The descriptions are general in nature and may be more clearly outlined by specific resolution of Council.

Capital Replacement Reserves

Capital replacement reserves are established to provide funding for the eventual replacement of capital assets. The annual contribution is based on the annual amortization expense associated with the asset. The annual contribution may be enhanced to provide for inflation related to replacement costs. Replacement reserves must be established for all capital assets.

Capital Replacement Reserve Funds

Capital Replacement reserve Funds are reserve funds established to provide funding for the replacement of specific capital assets. They differ from reserves in that they are adopted by specific resolution of council and provide for the accumulation of investment returns within the established reserve fund. They are a preferred way to assist in providing funding to match the growth in replacement costs over the long term. This type of funding should be considered for the replacement of major long term assets.

Capital Development Charges Reserve Funds

These reserve funds are established under the Development Charges Act (S.O.1997). These funds are created to help finance the growth portions of specific projects outlined in the most recent development charges study. They can only be used where growth related justification has been provided.

Debt

Debt represents the borrowing of funds which will be repaid over a long term period. Interest is charged annually based on the outstanding balance. The majority of debt is issued through private markets and have repayment periods of from 10 to 20 years. The period of debt issue should not exceed the expected life of the asset it is financing. Where a short term capital need exists (under ten years) for funds and the amount is not significant (under $100,000) staff may consider borrowing from internal funds. Such borrowing can reduce fees and increase investment returns.

Special Purpose Funds

Special Purpose Funds can be used where Council has approved a new capital project and requires the establishment of a funding source to pre-finance (in whole or in part) the project. An example would be where a project is to be funded through donations and Council establishes a fund such donations.

Operating Funds
Council may direct that a capital project be financed directly from operating funds. Such funding will have a direct impact on annual rate or levy requirements and should only be used in extreme cases where projects costs are low and the need is immediate.

Alternate Financing - Grants/Donations/Third Party Contributions
Staff will investigate all sources of alternate financing available for all capital projects. This funding may be in the form of other government grants, community donations or third party contributions related to development or other private needs.

RECOMMENDED FUNDING:

Replacement Assets
PSAB accounting rules require that the costs of tangible capital assets be charged out over their useful lives. What this means is that each operating year will include charges for the use of capital assets. These will be included in annual operating budget estimates and revenues will be collected to offset these costs. The cash generated from these expenses will be placed in replacement reserves to ensure that there are funds available when the time comes to replace them.

In most circumstances the price of assets increase over time. Where this happens and appropriate estimates of price increases can be made additional funding should be placed in replacement reserves. These amounts will be identified as inflation related replacement cost contributions.

New Assets
New assets cannot be funded from replacement reserve funding. Funding for new assets related to the provision of new services must be identified at the time of approval of the new service. Other sources of funds may include community donations, other government grants, new offsetting revenue generation, or debt. Council may also approve the creation of special funding programs to provide reserves or reserve funds to pre-finance a new asset.

Enhancements
Identified enhancements should not be funded from replacement reserves unless they can be shown to cost less than or be equal to the current reserve balance related to the asset. Where enhancements create costs in excess of the reserve balance additional funding must be determined. This funding will likely be similar to the funding outlined in the new assets section explained above.

In some instances assets are replaced with expanded assets that are required to increase service due to the impact of service growth. Population growth necessitates increased service provision so the asset expansion is describes as growth related. This growth related asset expansion should be funded from development charges. This will ensure that current residents are not paying for asset expansion that has been caused by population growth.

REPORTING

Staff will report regularly (at least annually) on the activities related to all capital financing programs. The purpose of such reporting is to ensure the County is meeting its need to operate in a financially sustainable manner.

The report will, at a minimum, provide information outlining account balances, projected future sources and applications of funds and anticipated future balances/requirements. The report will identify funding shortfalls and provide recommendations for improvements.

CAPITAL FINANCING PROCESS

The Financial Planning & Reporting Division will develop and implement a capital financing process that will ensure the directions outlined in this policy are followed in a consistent manner.