

Managers' Reports

Request for Recommendation Priorities Committee



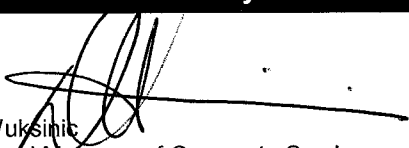
Type of Decision									
Meeting Date	September 10, 2003				Report Date	September 5, 2003			
Recommendation	<input checked="" type="checkbox"/>	Yes	<input type="checkbox"/>	No	Priority	<input checked="" type="checkbox"/>	High	<input type="checkbox"/>	Low
	Direction Only				Type of Meeting	<input checked="" type="checkbox"/>	Open	<input type="checkbox"/>	Closed

Report Title
Lease Financing Policy

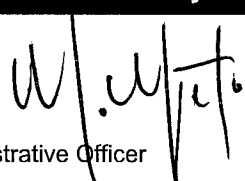
Policy Implications + Budget Impact	
<input checked="" type="checkbox"/>	This report and recommendation(s) have been reviewed by the Finance Division and the funding source has been identified
<input checked="" type="checkbox"/>	Background attached

Recommendation	
<p>THAT the Lease Financing Policy attached to this report dated July 17, 2003 be adopted; and</p> <p>THAT the appropriate by-law be passed.</p>	
<input type="checkbox"/>	Recommendation attached

Recommended by the General Manager



 D. Wuksinic
 General Manager of Corporate Services

Recommended by the C.A.O.

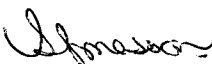

 M. Mieto
 Chief Administrative Officer

Report Authored By

Division Review



J. Van de Rydt
Co-Ordinator of Capital Budget and Risk Management



S. Jonasson
Director of Finance / City Treasurer

BACKGROUND

In the past few years, there were a number of well-publicized issues regarding capital financing leases and their impact on a few municipalities in Ontario (e.g. the MFP leases entered into by Toronto). On September 20, 2002, a new regulation was filed under the Municipal Act requiring municipalities to prepare and adopt a statement of leasing policies and goals. The new leasing provisions set out detailed requirements for standardized lease terms, disclosure, and other reporting and approval requirements for which the Treasurer is responsible. The lease financing policy essentially ensures that no "off-balance sheet" financing of major or significant asset acquisitions will occur without Council's prior approval and that all material financing lease rates or lease commitments are disclosed to Council prior to their approval.

Leases are categorized as either operating leases or capital / financing leases. An operating lease is similar to rental agreements in that lease payments are paid for the use of an asset but ownership remains with the lessor or landlord. An example would be a short-term vehicle lease. Capital / financing leases are leases where the benefits and risks of ownership of the asset acquired is considered, under generally accepted accounting principles, to have been transferred from the lessor to the City, such as the computers leased by the City.

The City has always been allowed to enter into lease agreements for the provision of municipal operating equipment and capital facilities. The City presently has a number of capital / financing lease agreements, mainly for computer equipment. There are also a number of operating leases in effect, for police vehicles, short-term vehicle leases during construction season, space on radio towers, and copier equipment. The recommended policy formalizes the procedures to be followed as directed by Ontario Reg. 265/02.

The Ministry of Municipal Affairs and Housing and other municipalities were contacted to obtain some sample lease policies. Policies from York Region, Niagara Region, the City of Mississauga and the Town of Orangeville were obtained and used as examples when drafting our own policy. The four sample policies were virtually identical and required only those material financing leases that extended beyond the term of Council (as stipulated under the Ontario Regulation 46/94) be reported to Council. In addition, none of the policies addressed operating leases. However, the local Ministry office indicates that the Regulation is intended to apply to both types of leases. Our policy has therefore been expanded such that all material leases are brought to Council for approval regardless of the term, and regardless of whether they are operating or capital / financing leases.

The attached policy statement therefore more than satisfies the requirements under the Act. The policy will ensure that necessary due diligence is undertaken by staff in the review of all financing lease agreements, and that City Council is provided full disclosure on the impacts of all material leases prior to entering into any agreement for the provision of municipal capital facilities or operating equipment.

The Regulation allows the City to distinguish between material and non-material leases, and allows the Treasurer to report on only material lease agreements.

For the purpose of this lease financing policy, the definition of material is:

- an individual lease with annual payments exceeding \$100,000, or
- any combination of non-material leases entered into or proposed to be entered into, for like or similar assets, in any particular year, if the total annual lease payments collectively exceed \$500,000.

The specific requirements to be satisfied for all material lease transactions includes:

- A complete repayment schedule for the term of the lease, including amounts required under any possible extension or renewal of the lease;
- An evaluation of the lease by the Treasurer, in which the effective rate of financing must be disclosed; and
- An authorizing by-law for the lease.

The 2003 annual debt and financial obligations repayment limit is \$40 million. The aggregate limit of \$500,000, mentioned above, equates to approximately 1¼ % of the City's annual debt and financial obligations limit. For the current year then, if the sum total of non-material lease payments for all computer leases, for example, was greater than \$500,000 they would be considered to have a material impact and would be reported to Council.

A non-material lease may be entered into without requiring the above reporting and approval procedures if the lease is deemed by the Treasurer and Council not to materially impact the City's debt and financial obligations repayment limit. ***For administrative purposes, it is recommended that this authority be delegated to the Treasurer so that Council is not required to deal with each individual lease which would be categorized as non-material, as defined in the policy.*** The lease would still be reported to Council if required under any other applicable by-law or approved policy (such as the Purchasing By-law) and procedure, but it would not have to be reported under the lease financing policy unless the threshold amount identified above is reached.

The proposed policy is attached.



LEASE FINANCING POLICY

STATEMENT OF POLICY AND GOALS

City Council has the authority under section 110 of the Municipal Act, 2001 to enter into an agreement for the provision of municipal operating equipment and capital facilities. Agreements under this section may include operating and capital / financing leases. As City Council recognizes that there are inherent risks associated with leasing, compliance with this policy will ensure that the necessary due diligence is undertaken by staff in the review of all lease agreements, and that City Council is provided full disclosure on the impacts of all material leases prior to entering into such agreements.

OBJECTIVES

The purpose of this policy is to establish a framework and outline requirements for entering into leases for operating equipment or capital facilities, and for the reporting of such leases to Council as required under the Municipal Act, and set out in Ontario Regulation 46/94, as amended by Ontario Regulation 265/02.

DEFINITIONS

Debt and Financial Obligation Limit A calculation provided annually to the municipality by the Ministry of Municipal Affairs and Housing that determines the maximum amount of annual debt servicing costs that a municipality can undertake or guarantee without seeking the approval of the Ontario Municipal Board.

Financing / Capital Leases A lease where the benefits and risks of ownership of the asset acquired is considered, under generally accepted accounting principles, to have been transferred from the lessee to the City.

This is an expanded definition from that outlined in Ontario Regulation 46/94, as amended by O.R. 265/02, which defines a financing lease as a lease that may or will require payment by the municipality beyond the term of Council. The expanded definition would require that all material leases be brought before Council regardless of their term.

Material Impact Costs or risks that significantly affect, or would reasonably be expected to have a significant effect on the City's debt and financial obligations limit.

Material Lease An individual lease with annual payments exceeding \$100,000, or any combination of non-material leases entered into or proposed to be entered into, for like or similar assets, in any particular year, if the total annual lease payments collectively exceed \$500,000.

Municipal Capital Facilities Assets, for example, land, works, equipment, machinery and related systems and infrastructures.

Non-Material Lease A financing lease in which the annual payment does not exceed \$100,000.

Operating Leases Similar to rental agreements in that lease payments are paid for the use of an asset, but ownership remains with the lessor or landlord.

LEGAL AUTHORITY

This policy is made in accordance with Ontario Regulation 46/94, as amended, and as required under the Municipal Act.

Among the specific requirements to be satisfied for all material leasing transactions:

- A complete repayment schedule for the term of the lease;
- An evaluation of the lease by the Treasurer, in which the effective rate of financing must be disclosed; and
- An authorizing by-law for the lease.

The requirements allow the City to distinguish between material and non-material leases, and requires the Treasurer to report on only material leases.

For the purpose of the lease financing policy, a material lease is:

- an individual lease with annual payments exceeding \$100,000, or
- any combination of non-material leases entered into or proposed to be entered into, for like or similar assets, in any particular year, if the total annual lease payments collectively exceed \$500,000.

PROCESS

Before Council enacts a by-law authorizing a material lease, the Treasurer shall prepare a report for Council with recommendations, assessing, in the opinion of the Treasurer, the costs and financial and other risks associated with the proposed lease, including:

- a comparison between the fixed and estimated costs and the risks associated with the proposed lease and those associated with other methods of financing,
- a statement summarizing, as may be applicable, the effective rate or rates of financing for the lease, the ability for the lease payment amounts to vary, and the methods or calculations, including possible financing rate changes, that may be used to establish that variance under the lease,
- a statement summarizing any contingent payment obligations under the lease that in the opinion of the Treasurer would result in a material impact for the municipality, including lease termination provisions, equipment loss, equipment replacement options and guarantees and indemnities,
- a summary of the assumptions applicable to any possible variations in the lease payment and contingent payment obligations,

- a schedule of all fixed amounts of payment required under the lease including amounts required under any possible extension or renewal of the lease, and
- any other matters the Treasurer or Council considers advisable including whether the scope of the financing lease warrants obtaining independent financial advice.

Where a proposed non-material lease in combination with all other non-material leases entered into or proposed to be entered into, for a class of assets, in any particular year, has a combined material impact of \$500,000, the proposed non-material lease is to be reported and reviewed by Council as if it were a material lease.

INDEPENDENT ADVICE

City staff are expected to have sufficient knowledge to properly evaluate standard leasing transactions. However, when in their opinion the appropriate level of knowledge does not exist for lease financing transactions that are unusually complicated or non-standard, or as otherwise directed, outside financial and/or legal advice will be obtained.

EXCEPTIONS

A lease may be entered into without reporting under this policy if the lease is deemed by the Treasurer and Council not to materially impact the City's debt and financial obligation repayment limit, as defined in this policy.

If, at any time, before the lease is entered into, the Treasurer becomes of the opinion that a changed circumstance with respect to the proposed lease may result in a material impact or a combined material impact for the municipality, a report shall be prepared as soon as reasonably possible and presented to Council.

DELEGATION

Council delegates the authority to the City Treasurer to determine if a lease is material, as defined in this policy.

REPORTING

Where Council has entered into one or more material leases in a year, the Treasurer shall prepare and present to Council, annually, a report containing:

- a description of the estimated proportion of the total financing arrangements that have been undertaken through leases to the total long-term debt of the City and a description of the change in that estimated proportion since the previous year's report; and
- a statement by the Treasurer as to whether, in her opinion, all material leases were entered into in accordance the provisions contained in this policy.