



*Robert Prosser & Associates Inc.*

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# **CITY OF SASKATOON**

## **Internal Loans Program**

### **Audit**

Additional controls are required to ensure due diligence in the loan application review process and to ensure effective disclosure of actual incremental revenues and/or cost savings from projects funded through productivity improvement and green loans.

**May 2008**

# Report Highlights

## Internal Loans Program Audit

**Additional controls are required with regard to retention of loan documents and evidence of due diligence, and public disclosure of actual incremental revenues and/or cost savings resulting from capital projects funded through internal loans.**

### Purpose of the Audit

The objectives of this audit was to determine:

- Whether adequate controls are in place to ensure policy compliance, loans are justified, loans are properly authorized, and loan objectives have been achieved; and
- To determine if a 5 year repayment term is appropriate.

### What Internal Audit Recommends

- Public disclosure of conclusions regarding policy compliance;
- Retention of loan documentation and evidence of due diligence;
- Public disclosure of loan objectives and actual results in terms of additional revenues and/or cost savings.

### What Internal Audit Found

We audited the extent to which adequate systems, practices and controls are in place to ensure that loans are justified and properly authorized. We conclude that adequate controls are in place with the following exceptions:

- We noted inconsistency with regard to public disclosure of Comptroller's Office conclusions regarding policy compliance;
- For several loans, we could not locate documentary evidence of due diligence undertaken by the Comptroller's Office;
- In some cases, the approved loans did not appear to meet the policy definition of a productivity improvement or green loan.

We audited the extent to which adequate systems, practices and controls are in place to ensure that loan objectives are achieved. We conclude that adequate controls are in place, although we note that there is no public disclosure of the extent to which loan objectives were achieved in terms of additional revenues and/or cost savings.

We audited the extent to which adequate systems, practices and controls are in place to ensure policy compliance. We conclude that adequate controls are in place, although our test results did disclose examples of loans that did not appear to meet the full extent of policy compliance. This appeared to be more a function of inconsistent application of internal controls than control weaknesses.

We evaluated whether the maximum 5 year repayment term for productivity improvement loans is appropriate. We conclude that in some instances an extension to the repayment terms of productivity improvement loans is appropriate. However, in such cases, we note that there is no public disclosure of the fact that payment terms exceed policy.

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# Chapter 1 – Introduction and Background

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**Introduction**

The corporate audit plan included the provision to conduct an audit of the City’s Internal Loans program related to productivity improvement and green loans.

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**Background**

Capital projects are a regular part of the City’s operations. General practices for going forward with these capital projects involve approval by management and City Council through the Capital Budget process. In the interest of promoting productivity improvements and utility savings (e.g. cost savings, additional revenues, energy reduction techniques and technologies, etc.) the City established a process of making internal loans available to departments, boards and commissions under very specific conditions. Productivity improvement loans focus on capital projects which will provide additional revenues or cost savings equivalent to, or greater than, related capital expenditures within 5 years. Green loans focus on capital projects which will create a reduction in utility costs equivalent to, or greater than, related capital expenditures within 10 years.

Over the past 11 years (1997-2007) the City of Saskatoon has issued 41 productivity improvement loans and 4 green loans to its departments and controlled corporations. While the majority of these loans are funded through the City’s “property realized reserve” it is the responsibility of the Comptroller’s Branch to determine whether funding is available (e.g. property realized reserve, debenture issuance, etc.) for each loan and if so at what interest rate. The total dollar value approved for productivity improvement and green loans over the 11 year testing period equalled \$11,532,431 and \$1,849,147 respectively.

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**Audit Objective & Scope**

The audit focused on whether adequate internal controls are in place and operating effectively to ensure:

- Policy Compliance;
- Loans are justified and properly authorized;
- Loan objectives have been achieved

The audit focused on internal controls surrounding productivity improvement and green loans.

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**Acknowledgements**

Robert Prosser & Associates Inc. wishes to extend special thanks to the General Manager of Corporate Services, the City Comptroller, the City Treasurer, City Solicitors and their staff for accommodating our requests for interviews, information and documents, and reviewing our audit findings.

## Chapter 2 – Loan Justification

We audited the extent to which adequate systems, practices and controls are in place to ensure that productivity improvement and green loans are properly justified. Key controls include formal loan application documentation process (implemented in the summer of 2007), independent review of loan applications by the Comptroller’s Office, and City Council approval of each loan. Opportunities for improvement include:

- Retention of documentary evidence of the Comptroller’s Office review of each loan justification report;
- Retention of all loan documentation and support for the due diligence performed by the Comptroller’s Office;
- More complete and relevant information in the justification reports submitted to City Council for approval.

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### **Justification criteria are set out in policy**

The primary justification for productivity improvement loans is repayment by additional operating revenues and/or operating expenditure savings (with or without a service enhancement) within a period that does not exceed five years (section 3.3 of Policy C03-027, Borrowing for Capital Projects).

The primary justification for green loans is repayment from utility expenditures savings within a period that does not exceed ten years (section 3.4 of Policy C03-027, Borrowing for Capital Projects).

In both cases, loan proposals must be for capital projects only. The term of each loan cannot extend beyond the useful life of the project.

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### **Justification reports are subject to independent review by the Comptroller’s Office**

Current practice requires all loan proposals to be reviewed by the Comptroller’s Office for recommendation to City Council.

In recognizing that the process of approving productivity improvement and green loans was too informal, the Comptroller’s Office implemented a revised application and justification process for approving these loans in spring of 2007. This revised process requires each department to submit a detailed loan application providing the relevant information to meet policy compliance (e.g. loan type, capital project number, project description, loan amount being requested, expected term of the loan, annual cost savings or incremental revenues, etc.). The Comptroller’s Office then determines whether the relevant policy criteria are being addressed and whether the appropriate funds are available. If so, an interest rate and repayment terms are established and provided to the department with a 45 day window to respond. If there are policy issues, the loan application/report is sent back for revision.

## *Loan Justification, cont'd*

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Once the initial justification report clears the Comptroller's Office, it is the responsibility of the Department General Manager to complete and submit a report to Council for official approval of the loan. This report is intended to describe the project including details on repayment period, cost savings, incremental revenues and/or energy savings.

Once Council approval is received, the Comptroller's Office ensures that the proper funds are provided to the department and that the loan details are entered into the Internal Loan database for tracking purposes. This database acts as the tool for ensuring the appropriate debt repayment charges are included as a line item in the applicable department's operating budget each year until the loan is repaid.

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**For several loans, we could not locate documentary evidence of due diligence**

In most cases, we could not find documentary evidence of the Comptroller's Office due diligence with regard to their review of loan justification reports and their communications with line departments and controlled corporations. For accountability purposes, we believe the Comptroller's Office should retain all records associated with each internal loan and documentary evidence of their review of loan justification reports and their subsequent communications with the applicable departments and controlled corporations. In turn, the official report submitted to City Council following communication from the Comptroller's Office, should include a formal statement advising City Council of the conclusions reached by the City Comptroller on policy compliance and availability of funds.

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**Our test period covered 11 years**

Our audit tests covered all productivity improvement loans (41) and all green loans (4) from 1997 to 2007 inclusive.

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**Several loans did not appear to meet the definitions for productivity improvement and green loans**

As part of our audit testing, we evaluated the validity of each productivity improvement and green loan considering the objectives for which these loans were approved.

While each of the loans tested met the criteria of a capital project, we found it difficult to conclude on the nature of all loans. Per our testing in Chapter 2 "Policy Compliance", we found several circumstances where the approved loan did not appear to meet the policy definition of a productivity improvement or green loan.

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**Justification reports are subject to Council approval**

After the loan application has been cleared through the Comptroller's Office, and assuming the Comptroller's Office recommends Council approval, the applicable department or controlled corporation is required to submit a formal justification report to City Council for approval.

Once the loan is approved by City Council, the funds are made available to the department or controlled corporation, and the City Comptroller takes steps to ensure loan repayment requirements are incorporated into the operating budget.

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**Justification reports to Council lack supporting detail on anticipated additional revenues and/or cost savings**

When Council receives the justification report associated with a productivity improvement or green loan, their expectations are:

- That the payback objectives (i.e. anticipated additional revenues and/or cost savings) meet policy requirements and are realistic and achievable;
- That civic funds are available to support the loan;
- That all relevant policies, regulations and sections of the Cities Act have been complied with;
- That the information provided is accurate.

When reviewing the loan applications, it is our understanding that City Council places reliance on information provided by management in their reports to City Council, the Comptroller's Office review process, and each manager's knowledge of their department.

As part of the audit, we reviewed each of the reports to City Council on productivity improvement loans and green loans issued by the City over the past 11 years, in order to determine whether adequate disclosure existed for City Council to provide their approval. What we found was inconsistency in terms of disclosure of anticipated additional revenues and/or cost savings. This information is required in order to provide City Council with the assurance that the loan has been subjected to independent review and to provide a basis for holding management accountable for the anticipated additional revenues and/or cost savings.

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**Recommendations**

1. That management ensure all reports to City Council requesting approval of productivity improvement and green loans, include full disclosure of anticipated additional revenues and/or cost savings.

*Loan Justification, cont'd*

2. That each loan justification report submitted to City Council for approval, include a statement indicating whether the loan is supported by the Comptroller's Office, in order to provide City Council with assurance that funds are available and that all relevant policy criteria have been met.
3. That the Comptroller's Office retain on file copies of all productivity improvement and green loan applications and justification reports and documentary evidence of their due diligence on each loan.

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**Management Response**

1. *Agree*
2. *Agree*
3. *Agree*

# Chapter 3 – Achievement of Loan Objectives

We audited the extent to which adequate systems, practices and controls are in place to ensure adequate disclosure on the extent to which loan objectives are achieved.

We conclude that adequate disclosure does not occur. Although the operating budget provides debt repayment information, it does not include disclosure of whether loan objectives materialized in terms of anticipated additional revenues and/or cost savings. Our recommendations include:

- A statement in the applicable program operating budget disclosing the extent to which the loan objectives have been achieved;
- Retention of relevant documentation, by the applicable department, supporting the extent to which loan objectives have been met.

**The criteria for setting loan objectives are set out in policy**

The criteria for setting productivity improvement loan objectives, in terms of anticipated additional revenues and/or cost savings, are driven by the requirement for the loans to be repaid by additional operating revenues and/or operating expenditure savings (with or without a service enhancement) within a period that does not exceed five years (section 3.3 of Policy C03-027, Borrowing for Capital Projects).

The criteria for setting green loan objectives, in terms of anticipated energy cost savings, are driven by the requirement for the loans to be repaid from utility expenditures savings within a period that does not exceed ten years (section 3.4 of Policy C03-027, Borrowing for Capital Projects).

**Loans are to be justified on the basis of these criteria**

The documentation process for justifying productivity improvement and green loans includes provision for calculating, and providing to the Comptroller’s Office for review, the anticipated additional revenues and/or cost savings.

**Justification reports submitted to City Council, and the annual operating budget, are the primary vehicles for public disclosure of loan objectives**

The justification reports to City Council are to include details on the anticipated additional revenues and/or cost savings, so that an informed decision can be made at the time of loan approval.

The operating budget includes a specific line item in the applicable program budget, for debt repayment. When the first budget figure for debt repayment appears in the program operating budget, there is also an explanation of the purpose for the loan.

## *Achievement of Loan Objectives, cont'd*

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**The operating budget does not provide adequate disclosure to City Council and the public on actual incremental revenues and/or cost savings**

Reliance is placed on the annual operating budget as the vehicle for disclosing whether individual productivity improvement loans and green loans are meeting, or have met, their intended objectives, in terms of additional revenues and/or cost savings.

As noted above, current practice includes adding a line item to the applicable program operating budget for the debt repayment, along with an explanation of the purpose of the loan in the first year of repayment. In the final year of repayment, management typically provides a brief statement in the operating budget explaining the change in “debt charges” (reduction in debt charges due to repayment of loan). However, there is no disclosure on whether the anticipated additional revenues and/or cost savings actually materialized from the applicable capital project.

What we found through our audit testing of productivity improvement and green loans were several situations where the additional revenues or cost savings were not realized to the extent they were presented in the approved justification reports. If the anticipated additional revenues and/or cost savings do not materialize, it is entirely possible that the project, for which the loan was taken out, ended up costing more than the financial return. If so, the mill rate would be affected.

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**There is no formal method for confirming whether loan objectives have been achieved**

The current process and policy does not require post loan disclosure regarding the achievement of loan objectives at the time the productivity improvement or green loan is repaid, nor during the time in which the loan exists. Discussions with several City departments indicate management support for the current practice as it is felt that City Council receives an appropriate level of detail through the operating budget and year-end financials. As noted above, we do not believe the operating budget currently provides adequate disclosure of actual incremental revenues and/or cost savings.

Residual risks associated with not requiring post disclosure of each internal loan include the potential use of funds for purposes not intended, and City Council and the public not knowing the mill rate impact of failure to achieve the anticipated additional revenues and/or cost savings.

Assuming that the anticipated additional revenue and/or cost savings materialize, the department involved with each loan should theoretically be able to operate with a budget reduction equivalent to at least the annual amount of debt repayment, once the loans have been paid off.

However, we note that it is standard practice for management to state, in the operating budget, what they propose to do with the

## *Achievement of Loan Objectives, cont'd*

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funds freed up as a result of repaid loans. This provides City Council with the opportunity to question management on the reallocation of these funds.

Our test results disclosed situations where the additional revenues or cost savings anticipated and used to justify loans did not materialize. Post loan disclosure would help to conclude on whether actual results have been achieved and, if not, why not. The requirement for each department to retain on file support for the achievement of loan objectives, would also provide the means to hold responsible managers accountable for their capital investment decisions.

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### **Recommendations**

4. That there be public disclosure on the extent to which the loan objectives were achieved in terms of anticipated additional revenues and/or cost savings.
5. That management retain on file, documentation to support management representations made pursuant to Recommendation #4.

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### **Management Response**

4. *Agree*
5. *Agree*

# Chapter 4 – Policy Compliance

We audited the extent to which adequate systems, practices and controls are in place to ensure policy compliance with regards to issuing internal debt through a productivity improvement or green loan.

We conclude that adequate controls are in place. However, we noted several areas of potential non-compliance that may be the result of failure to consistently apply the controls.

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**Compliance criteria are set out in policy**

The policy criteria governing productivity improvement loans and green loans are set out in City Council Policy No. C03-027, Borrowing for Capital Projects. A copy of the policy has been attached as Appendix A.

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**Controls are in place to ensure policy compliance**

The control process for ensuring policy compliance includes independent review of justification reports, City Council approval of loans, and an internal database on loans.

**Justification Reports.** Prior to City Council receiving a loan application for approval, management is required to submit a justification report to the Comptroller’s Office outlining the details of the capital project (e.g. funding requirements, incremental revenues or cost savings, etc.). The Comptroller’s Office is responsible for ensuring each loan application meets policy compliance along with determining if the required funds are available. Given that funds are available, the Comptroller’s Office will establish the repayment terms including the applicable interest rate.

**City Council Approval.** All internal loans, including productivity improvement and green loans, require City Council’s approval. This is accomplished either through the Capital Budget process or via a special report submitted to City Council.

**Internal Loan Database.** The Comptroller’s Office maintains a database of all internal loans issued by the City of Saskatoon. This database includes the repayment terms, loan type, interest rate, etc. for all internal loans. The database is used to ensure loan repayment requirements are met and are incorporated into the applicable program operating budgets.

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**We found examples of non-compliance**

We reviewed 100% of the productivity improvement and green loans issued over the past 10 years (i.e. 1996-2006), testing where applicable, all 2007 loans. This sample included 45 loans of which 41 were productivity improvement loans and 4 were green loans. In

most cases we were able to locate supporting documents to facilitate our analysis of compliance.

With regards to ensuring policy compliance for productivity improvement and green loans, we identified several areas under the “Borrowing for Capital Projects” policy where compliance was questionable. Some of examples of this include:

- Section 3.3(e) “Debt incurred for productivity improvements or green loans shall be evaluated solely on satisfying payback criteria.”
  - Some justification for productivity improvement loans focused on best business practices rather than cost savings or incremental revenues to repay the loan.
  - In some cases, justification reports were submitted with no apparent financial analysis attached.
- Section 3.3(a)(ii) “...that capital expenditures will be fully repaid by additional operating revenues and/or operating expenditure savings...”
  - In some cases, justification for loans focused on regular fee increases for repayment rather than additional revenues due to productivity.
  - In some cases, forecasted increases in revenues and/or cost savings did not materialize resulting in regular operations supporting the repayment obligations. This occurred through either an increase in the operating budget or an adjustment to the transfers to/from an internal reserve.

What we found through our testing was a variety of circumstances where the loan issued did not appear to meet the full extent of policy compliance. As noted in the chapters above, we suggest implementation of additional controls focused on ensuring policy compliance and disclosing achievement of the loan objectives (i.e. savings, incremental revenues).

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**The current policy C03-027 Borrowing for Capital Projects has not been revised since February 17, 1997.**

Periodic review of established policies is an implicit requirement in any policy management process. While revisions are not always required, the regular review of policies helps to ensure they are current and effective in meeting policy objectives.

The effective date of Policy No. C03-027, Borrowing for Capital Projects, was over ten years ago, February 17, 1997. The Policy does not appear to have been reviewed and updated since then. We note, for example, that policy continues to refer to the Auditor General's Office as the participating party responsible for analyzing loan proposals to determine the potential of achieving the payback criteria and to determine the annual borrowing requirements.

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**Recommendations**

6. That Policy C03-027 "Borrowing for Capital Projects" be updated.

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**Management Response**

6. *Agree*  
*Policy is currently under review. Revisions have been made by the Investment Services Manager, those revisions currently under review by the Investment Committee.*

## Chapter 5 – Maximum Repayment Term of Loan

The maximum term for productivity loans, per policy, is five years. We were asked to comment on whether the five year requirement is necessary and whether it is being followed.

We found some productivity loans with repayment schedules that exceeded five years. We conclude that in some instances, it is appropriate for the loan repayment schedule to exceed five years, as long as the payback is there in terms of incremental revenues and/or cost savings.

There should be full public disclosure when extended repayment terms are being approved by City Council.

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**Maximum repayment terms are set out in policy**

Per Policy No. C03-027, Borrowing for Capital Projects, the maximum term for repayment of:

- Productivity Improvement Loans is the lesser of 5 years or the useful life of the project;
- Green Loans is the lesser of 10 years or the useful life of the project.

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**Test results disclosed loans that exceeded the maximum repayment term**

Through our testing, we noted five out of forty one productivity loans issued over the past 11 years (1997-2007) were approved with a term greater than five years. All reports disclosed the term of the loan repayment but did not explicitly indicate that the terms exceeded the policy maximum of 5 years. Although the terms exceeded the 5 year maximum, we note that circumstances relating to each of these loans required the terms of repayment to be longer. Assuming that appropriate justification can be provided to satisfy both management and City Council, it seems reasonable that the repayment terms could be extended beyond 5 years under special circumstances. However, we believe there should be explicit disclosure of the fact that the repayment terms exceed the 5 year maximum set out in policy.

All green loans met the policy criteria governing repayment terms.

Through discussions with City Solicitor's Office, it is our understanding that there are no legislative constraints on the City's ability to authorize productivity loans with repayment schedules extending beyond five years, assuming the repayment schedule is reasonable and does not place the City's funds at undue risk. We would suggest that all extended repayment terms require appropriate justification prior to approval by both the Comptroller's Office and City Council and that the report to Council include disclosure of the extended payment terms.

## *Maximum Repayment Term of Loan, cont'd*

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**Recommendations**

7. That in circumstances where a productivity improvement loan repayment term is expected to exceed 5 years, the loan justification report presented to City Council include full public disclosure of the fact that the repayment term exceeds policy.

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**Management Response**

7. *Agree*

## Chapter 6 – Implementation Plan

RECOMMENDATION	MANAGEMENT RESPONSE	IMPLEMENTATION DATE
1. That management ensure all reports to City Council requesting approval of productivity improvement and green loans, include full disclosure of anticipated additional revenues and/or cost savings.	<i>AGREE</i>	June 1, 2008
2. That each loan justification report submitted to City Council for approval, include a statement indicating whether the loan is supported by the Comptroller’s Office, in order to provide City Council with assurance that funds are available and that all relevant policy criteria have been met.	<i>AGREE</i>	June 1, 2008
3. That the Comptroller’s Office retain on file copies of all productivity improvement and green loan applications and justification reports and documentary evidence of their due diligence on each loan.	<i>AGREE</i>	June 1, 2008
4. That there be public disclosure on the extent to which the loan objectives were achieved in terms of anticipated additional revenues and/or cost savings.	<i>AGREE</i>	June 1, 2008
5. That management retain on file, documentation to support management representations made pursuant to Recommendation #4.	<i>AGREE</i>	June 1, 2008
6. That Policy C03-027 “Borrowing for Capital Projects” be updated.	<i>AGREE</i> <i>Policy is currently under review. Revisions have been made by the Investment Services Manager, those revisions currently under review by the Investment Committee.</i>	July 1, 2008

*Implementation Plan, cont'd*

<b>RECOMMENDATION</b>	<b>MANAGEMENT RESPONSE</b>	<b>IMPLEMENTATION DATE</b>
7. That in circumstances where a productivity improvement loan repayment term is expected to exceed 5 years, the loan justification report presented to City Council include full public disclosure of the fact that the repayment term exceeds policy.	<i>AGREE</i>	June 1, 2008

# Appendix A

**NUMBER**  
C03-027

<b>POLICY TITLE</b> <i>Borrowing for Capital Projects</i>	<b>ADOPTED BY:</b> <i>City Council</i>	<b>EFFECTIVE DATE</b> <i>February 17, 1997</i>
<b>ORIGIN/AUTHORITY</b> <i>Legislation &amp; Finance Committee Report No. 11-1987, 33-1987, 41-1987, Administration &amp; Finance Committee Report No. 3-1997</i>	<b>CITY FILE NO.</b> <i>CK 1750-1; 1895-3; 1610-1; 1815-1; 1702-1; 1500-1</i>	<b>PAGE NUMBER</b> <i>1 of 6</i>

1. PURPOSE

To provide a method of financing municipal capital projects for which:

- a) Sufficient funds are not otherwise available in existing reserves or through external sources.
- b) It is intended to recover all or part of the capital costs from future operating revenues or operating savings; and/or,
- c) It would be equitable to extend the capital financing to future users.

2. DEFINITIONS

2.1 External Debt - refers to all debt incurred by the issuance of debentures and similar instruments.

2.2 Internal Debt - refers to funds loaned from existing civic reserves, in accordance with various City policies, for the financing of capital projects.

2.3 Productivity Improvements - refer to capital projects which will result in the delivery of an existing operating program (with or without a service enhancement) at a lower cost or will generate greater revenues through increased utilization.

2.4 Tax-supported Debt - refers to all internal and external debt which is not fully repaid from direct charges to the user or beneficiary (i.e. utility rates, local improvement charges, etc.).

2.5 Utility Debt - refers to all internal and external debt incurred for capital projects undertaken by the Electrical Utility Branch of the Public

Works Department, Water and Sewage Utilities of the Environmental Services, and Transit Branch of the Transportation Department.

2.6 Debenture Issuance Costs - refers to the net amount of any premium/discount plus administrative costs associated with a 'debenture issue'. A 'debenture issue' involves the consolidated borrowing, at one point in time, of amounts that may be authorized by several bylaws.

3. POLICY

All decisions with respect to incurring additional internal and external debt shall be evaluated from the perspective of not adversely affecting the City of Saskatoon's overall credit worthiness (as measured by its external credit rating) and the on-going financing of its committed programs (as measured by the ability of the municipal mill rate and other operating revenues to accommodate the associated additional debt repayment requirements).

a) Internal and external debt shall be utilized as a source of financing for capital projects and will not be available for on-going expenditures that are or would be financed initially from the Operating Budget.

b) A 10% downpayment provision must be made for all unfunded capital projects that require internal or external borrowing.

i) The 10% downpayment shall be financed from the Operating Estimates in the year that the decision to borrow takes effect.

ii) Capital projects financed through local improvement debentures or Productivity Improvement Loans shall be excluded from the 10% downpayment requirement.

c) All borrowing requirements for each year will be identified in the annual Capital Budget and upon approval of the document, the approved borrowing program shall be undertaken on a global, as opposed to a project-specific, basis. Such borrowing programs shall proceed primarily on the basis of market opportunities and trends. Cash flow requirements will be a secondary consideration.

d) Proposals to incur additional utility debt shall be evaluated in relation to the long-term debt repayment impact on the associated user fees.

e) Debt incurred for productivity improvements or green loans shall be evaluated solely on satisfying the financial payback criteria.

f) Internal loans shall be made only from those reserves and under conditions specified in Policy 03-003 ("Reserves for Future Expenditures").

3.1 External Debt

a) External debt may be used as a source of financing for municipal capital projects (other than local improvements) where:

i) the project's estimated useful life exceeds 10 years and,

ii) the amount to be borrowed for the project exceeds \$500,000.

b) All repayment costs (i.e. both principal and interest) will be charged, on an annual basis, to the appropriate operating program.

c) In all such cases, the projects designated for external debt financing will be required to incorporate in their capital budgets a provision of at least 0.5% of the amount borrowed in order to finance the administrative costs of issuing the debentures (i.e. outside legal costs, printing and delivery of debentures, Local Government Board approval fee, etc.).

d) All debt incurred for local improvements shall be undertaken by issuing debentures.

e) Debenture issuance costs that exceed \$50,000 will be amortized over the life of the debentures and proportionately charged to the relevant operating programs. Debenture issuance costs of \$50,000 or less will be written off in the year that it is incurred.

3.2 Internal Debt

Internal debt may be used as a source of financing for municipal capital projects where:

- the project's estimated useful life is 10 years or less; or,
- the amount to be borrowed is \$500,000 or less.

a) Projects which have an estimated debt financing requirement in excess of \$500,000 and a useful life greater than 10 years may be financed from internal borrowing if this is deemed to be in the best long-term financial interests of the City.

b) Notwithstanding other City policies, the maximum term of any internal loan (excluding those for productivity improvements) is the lesser of 10 years or the estimated useful life of

the project. Interest will be charged, on an annual basis, at the equivalent investment rate (as determined by the Investment Committee), with the associated interest revenue credited in accordance with the City's accounting procedures and financing policies. All internal loans authorized in the Capital Budget shall be issued on July 1 of the budget year and subsequent repayment shall occur annually on July 1 of each subsequent year for the term of the loan.

3.3 Productivity Improvement Loans

All loans for productivity improvements will be financed through the issuance of internal debt and shall be available to all civic departments, boards, and commissions that are able to demonstrate expected achievement of the payback requirements.

a) To be eligible for productivity improvement loans, projects must satisfy all of the following criteria:

i) the proposal is a capital project; and,

ii) the capital expenditures will be fully repaid by additional operating revenues and/or operating expenditure savings (with or without a service enhancement) within a period that does not exceed five years. The repayment shall include an interest charge at the equivalent investment rate, as determined by the Investment Committee. All repayment costs will be charged directly to the appropriate operating program of the civic department, board of commission responsible for the proposal.

b) All productivity improvement loans must be approved by City Council, upon recommendation of the Finance Department.

c) The General Manager, Finance Department shall determine in advance the total amount of funds available each year, for productivity improvement loans.

3.4 Green Loans

All loans for energy and water use reductions will be financed through the issuance of internal debt and shall be available to all civic departments, boards and commissions that are able to demonstrate expected achievement of utility savings.

## *Appendix A, cont'd*

a) To be eligible for green loans, projects must satisfy all of the following criteria:

i) the proposal is a capital project;

ii) the proposal utilizes proven energy reduction techniques and technologies; and,

iii) the capital expenditures will be fully repaid from utility expenditure savings within a period that does not exceed ten years. The repayment shall include an interest charge equivalent to the City's borrowing rate, as determined by the Investment Committee. All repayment costs will be charged directly to the appropriate operating program of the civic departments, board or commission responsible for the proposal.

b) There is no maximum loan size.

c) All green loans must be approved by City Council, upon recommendation of the Finance Department.

### 4. RESPONSIBILITIES

#### 4.1 Investment Committee:

a) Will make recommendations to City Council on the administration of this policy,

b) Will determine the interest rate that is levied on internal debt and productivity improvement loans.

#### 4.2 Office of the Auditor-General:

a) Will analyze productivity improvement loan proposals to determine the potential of achieving the payback criteria,

b) Will determine the annual borrowing requirements as specified through the Capital Budget.

#### 4.3 City Council:

a) Approves the annual internal and external borrowing requirements in conjunction with its review of the Capital Budget/Plan,

b) approves all productivity improvement loans.