



Staff Report

DATE: April 3, 2019

FILE: H-FIN

TO: Chair and Directors
Regional Hospital District Board

FROM: Russell Dyson
Chief Administrative Officer

Supported by Russell Dyson
Chief Administrative Officer

R. Dyson

RE: **Future Expenditure Reserve and Debt Repayment Reserve**

Purpose

To provide information to the Comox-Strathcona Regional Hospital District (CSRHD) board as requested at the March 7, 2019 meeting regarding early repayment of the North Island Hospitals Project (NIHP) debt, the establishment of a maximum future expenditure reserve and establishment of a debt repayment reserve.

Recommendation from the Chief Administrative Officer

This report is provided for information as requested by the board.

Executive Summary

- The board asked staff to explore options to repay the NIHP debt ahead of the 10 year maturity date of September 2028. Municipal Finance Authority (MFA) has advised that partial debt payments are not permitted and that the only option would be for the principal and interest for the full term to be repaid at once. It is not economically viable to consider early repayment and staff recommend that this not be pursued further.
- According to the *Hospital District Act*, reserve funds for regional hospital districts are not established by bylaw like they are in regional districts and municipalities so a debt repayment reserve is not required to be established. Reserve funds can be used for any CSRHD purpose.
- The financial plan has been developed for several years with a \$10 million target for the reserve as there are no significant capital works being considered by Island Health.
- With the \$17 million annual requisition, the reserve would reach \$64 million by 2028 assuming a two per cent rate of return.
- The current mandate of the CSRHD is capital projects and equipment for acute care facilities and there are no major projects on the horizon according to Island Health.
- To fully fund the \$1.8 million annual Island Health funding envelope through investment earnings, the reserve balance would need to be approximately \$93 million based on a two per cent rate of return. This strategy would shift the burden for paying for annual capital needs to taxpayers in advance of the projects being realized.

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Background/Current Situation

In 2018, the CSRHD board approved entering into a 10 year debenture debt issue with the Municipal Finance Authority (MFA) in the amount of \$89 million to fund the outstanding commitment for the NIHP. The original projection for the NIHP financing was that borrowing of up to \$177 million would be required over a 30 year repayment term. This reduced term was realized with the use of interim financing and careful cash management prior to and during the construction years.

At the March 7, 2019 CSRHD board meeting, staff were directed to investigate a maximum reserve fund level and the establishment of a debt reserve fund to potentially repay the NIHP sooner than 2028.

Early Repayment of the NIHP Debt

MFA has reconfirmed that lump sum payments during a 10 year debenture are not permitted. The only opportunity for repayment would be if the full principal outstanding plus all interest to the end of the term were paid on a scheduled principal payment date. With this option, the board would be forfeiting the three per cent actuarial adjustment which represents approximately \$11.5 million over the 10 year term, \$9 million of it accruing in the last five years. Staff are not recommending that early repayment be pursued further.

Establishment of a Debt Reserve Fund

Reserve funds in a regional hospital district are not required to be established by bylaw with a specific purpose as they are in regional districts and municipalities. The reserves held by the CSRHD can be used for any CSRHD purpose. With MFA's clarification regarding the limitations of early repayment, staff are not recommending setting up a separate debt repayment reserve fund.

Maximum Reserve Fund Level

For the past several years, the financial plan has been developed based on a principle of maintaining \$10 million in the reserve fund. With the two new hospitals completed, and Island Health's confirmation at the January 2019 CSRHD board meeting that there are no significant projects on the 10 year horizon, a \$10 million reserve fund would appear to be sufficient. Island Health's annual funding envelope is \$1,850,000 per the financial planning policy and is currently funded from the annual requisition.

Investing Reserve Funds

As well as financing, MFA offers investment portfolios for a variety of investment terms. A new mortgage investment product will be available later in 2019 specifically for longer term, stable investing. If the board wishes to retain the requisition level at \$17 million per year which provides a substantial contribution to reserves annually, the board could direct staff to work with MFA to maximize the return on investment of the funds held in reserves.

Financial Factors

At the current requisition rate of \$17 million per year, an average of \$4 million plus earned interest would be available to be contributed to reserves annually as demonstrated in Table 1.

Table 1: Annual Requisition and Funding Requirements

| | | |
|---|-----------|---------------------|
| Annual Requisition (since 2015) | | \$17,000,000 |
| Estimated Annual Funding Requirements | | |
| NIHP annual debt payments (until 2028) | | 10,718,700 |
| Other annual debt payments (until 2026) | \$ 24,800 | |
| Funding commitment to Island Health (per policy) | 1,850,000 | |
| Funding commitment to other named facilities (per policy) | 30,000 | |
| Board governance and administrative expenses | 308,500 | |
| Annual funding (net of NIHP debt) | | 2,213,300 |
| Total estimated annual funding requirements | | \$12,932,000 |
| Potential Annual Reserve Contribution | | \$4,068,000 |

The board has expressed interest in a strategy to fund the annual requirements by way of interest earned on the reserve fund balance. In order to generate sufficient revenue to meet the annual funding commitment to Island Health of \$1,850,000, the reserve would need to be approximately \$93 million, assuming a two per cent rate of return.

At the existing requisition level, Table 2 projects the reserve fund balance using projected annual contributions and estimated interest earnings assuming a two per cent return. By 2029, the year following the repayment of the NIHP debt, the reserve is estimated to be \$82 million, and to have earned approximately \$7.6 million in interest over the term.

For this example, it is assumed the interest is reinvested back into the reserve; however, the investment earnings could be used to partially finance annual commitments.

Table 2: Projected Reserve Fund Balance based on a \$17 million Annual Requisition

| | Projected Annual Contribution | Estimated Interest Earnings 2% | Ending Balance |
|-----------------------------------|--------------------------------------|---------------------------------------|-----------------------|
| Balance at December 31, 2018 | | | \$11,816,982 |
| 2019 (net of project commitments) | \$1,868,473 | \$ 80,000 | 13,765,455 |
| 2020 | 4,525,309 | 275,309 | 18,566,073 |
| 2021 | 4,621,321 | 371,321 | 23,558,715 |
| 2022 | 4,721,174 | 471,174 | 28,751,063 |
| 2023 | 4,825,021 | 575,021 | 34,151,105 |
| 2024 | 4,933,022 | 683,022 | 39,767,149 |
| 2025 | 5,045,343 | 795,343 | 45,607,835 |
| 2026 | 5,162,157 | 912,157 | 51,682,149 |
| 2027 | 5,308,443 | 1,033,643 | 58,024,235 |
| 2028 | 5,435,285 | 1,160,485 | 64,620,005 |
| 2029 (NIHP debt repaid in 2028) | 16,285,902 | 1,292,400 | \$82,198,307 |
| | \$62,731,450 | \$7,649,875 | |

Options

1. To maintain the \$17 million requisition and contribute the excess funds to the reserve annually and explore investment options through the MFA.
2. To reduce the requisition in the next financial plan and set a cap for the reserve fund at \$10 million.
3. Other options at the direction of the board.

Citizen/Public Relations

A key principle to intergenerational equity is to ensure that the generation benefiting from the expenditure is also the one paying for it.

The CSRHD taxpayers for the past 10 years and for the next 10 years will be bearing the capital cost of constructing the two hospitals which have a 30 year agreement with the private sector partner. As well as funding the full capital cost of the hospitals over 20 years, by 2029, at the \$17 million tax requisition level, an estimated reserve fund of \$82 million will have been accumulated.