DEBT AND FINANCIAL PORTRAIT

INDEBTEDNESS

The city Administration funds its capital expenditures primarily through long-term debt. The city's debt profile is heavily influenced by projects carried out under past and present three-year capital works (TCWP) budgets.

In special cases, the city may also borrow to finance other kinds of expenditures falling within its areas of authority. This situation arose, for example, in the refinancing of the initial actuarial liability of the former city that began in 2003 and continued in 2004 and 2005. As at December 31, 2008, gross debt issued by the Ville de Montréal thus stood at $6.6 billion. Long-term debt hovers around $5.2 billion, excluding debt issued for refinancing the actuarial liabilities of five of the six retirement plans for employees of the former city.

Matured loans and refinancing, debt should total $5.3 billion at the end of 2009, in consideration of capital expenditures for 2009.

Capital expenditures affect the city's level of indebtedness. They also affect the Operating Budget not only in terms of operating expenditures, but in terms of the cost of debt. That is why investment levels must be set with a constant concern for containing the scope of the debt, thus limiting the pressure exerted by the cost of this debt on the city's Operating Budget.

The table on the following page provides a better idea of how indebtedness affects the city's Operating Budget by distinguishing between gross and net costs of the debt. This table also reveals the share of costs now assumed by Montréal urban agglomeration taxpayers.

The $871.3 million earmarked in the 2010 Budget for gross funding costs is equivalent to 20.2% of all funding costs and other financial activities. Taxpayers, however, are not responsible for a large share of this cost, which is partially repaid by Government of Québec grant programs and by fees charged by the Commission des services électriques de Montréal (electrical service commission). Long-term investments are, moreover, obtained in view of accumulated sinking fund reserves, to ensure future loan repayment. These investments generate interest that serves to defray a share of taxpayer cost. Net debt in 2010 stands at $617.6 million, equivalent to 14.3% of all operating expenditures and other financial activities.

A share ($107.3 million) of the gross cost of debt in 2010 is attributable to the refinancing of the initial actuarial liability of five of the six retirement plans for employees of the former city. Since the strategy in question has enabled the city to repay the retirement plans, it is no longer necessary to make special contributions to them. Loans were, however, taken out to achieve this goal, thus generating funding costs.

Excluding funding costs for refinancing of the initial actuarial liability, gross funding costs stand at $764 million, or 17.7% of all operating expenditures. The net cost is $534.6 million, or 12.4% of all operating expenditures.

From the time the urban agglomeration was established, its taxpayers have been responsible for a portion of the cost of debt. For 2010, their contribution stands at $217.3 million.

Table 20
2010 Cost of Debt
(In thousands of dollars)

	2009 Restated	Total cost 2010	Refinancing of unfunded actuarial liability 2010	Total cost excluding unfunded actuarial liability 2010
Gross cost of debt				
Interest and other charges	410,513.2	418,764.4	90,775.8	327,988.6
Reimbursement of capital expenditures and contributions to the sinking fund	345,264.1	352,119.5	-	352,119.5
	755,777.3	770,883.9	90,775.8	680,108.1
Allocation to debt repayment	11,822.4	11,448.3	7,626.4	3,821.9
Capital repayement through subsidies	78,289.7	88,942.7	8,880.8	80,061.9
Total gross debt cost	845,889.4	871,274.9	107,283.0	763,991.9
Less:				
Sinking fund investment income	54,611.3	51,174.0	1,907.3	49,266.7
Premium on issue - Deferred and interest revenue	2,477.8	975.3	975.3	-
Amounts under the responsibility of reconstituted municipalities	2,485.2	-	-	-
Québec government subsidies receivable				
- for interest portion	68,316.9	70,097.9	12,519.6	57,578.3
- for capital portion	78,289.7	88,942.7	8,880.8	80,061.9
	206,180.9	211,189.9	24,283.0	186,906.9
Less:				
Collection in the form of royalties from underground conduit funds	40,462.7	42,464.1	-	42,464.1
Total net cost of debt charged to taxpayers	599,245.8	617,620.9	83,000.0	534,620.9
Distribution of this charge between taxpayers				
Urban agglomeration taxpayers	**197,989.6**	**217,295.8**	**-**	**217,295.8**
Ville de Montréal taxpayers	**401,256.2**	**400,325.1**	**83,000.0**	**317,325.1**
Proportion of the debt service costs compared to all operating expenses and other financial activities				
Gross cost of debt	20.6%	20.2%	2.5%	17.7%
Net cost of debt	14.6%	14.3%	1.9%	12.4%

DEBT MANAGEMENT

Montréal's Executive Committee, in its capacity as administrator of public funds, places great emphasis on sound management of the city's financial resources. A key factor in this management process obviously pertains to the debt. Public debt must be administered in a reasonable manner, which means taking into account the ability of taxpayers to pay (net cost of debt), while providing residents with quality services.

In 2005, Moody's Investor Services upgraded the city's credit rating from "A2" to "A1." In 2006, it again upgraded Montréal's credit rating, this time from "A1" to "Aa2," the best rating in Montréal's history. Moody maintained this rating in 2007, 2008 and 2009. Standard and Poor's has renewed its rating of Montréal as "A+ stable.

As mentioned above, Montréal borrows to finance most of its investments. Although there is no legal limit to Montréal's level of indebtedness, the city should not acquire excessive debt and must therefore make certain choices. The city Administration has accordingly developed a financial strategy to take this indebtedness into account. The city introduced the resulting debt-management policy in the 2004 Budget.

This debt management policy is designed to:

- Define debt management goals.
- Make the decision-making process more systematic.
- Ensure consistent decisions on indebtedness, by introducing discipline and continuity into the decision-making process.
- Acquire a framework aimed not only at maintaining, but at improving, Montréal's financial situation.

Through its debt management policy, the city intends to:

- Responsibly and prudently manage the city's debt, which involves adopting a formal framework setting out rules for borrowing.
- Adopt practices that serve to remedy the city's high level of indebtedness.
- Ensure stable access to capital markets, particularly at advantageous rates.
- Improve its financial situation and thereby maintain, or if possible, boost, the city's credit rating.

Practices adopted within the framework of Montréal's public debt management policy fall under five broad headings. Any exceptions to this policy must be approved, as the case may be, by the City Council or the Urban Agglomeration Council. For further information on this topic, readers may refer to the city's debt management policy online at: **ville.montreal.qc.ca**/finances.

A variety of debt management policy measures have an impact on budgeted expenditures. Pursuant to this policy, for example, the city is applying $25.1 million of voluntary contributions in 2010 to accelerated reduction of the municipal debt. The debt management policy will accordingly have served to trim the debt by $169.7 million from the time that it was established in 2004 through the end of 2010.

Implementation of the debt management policy is helping to raise the city's financial profile and thus its credit rating. This policy also sets certain guidelines in terms of indebtedness and debt service burden.

The following section provides a financial portrait that clearly outlines the city's debt status and some of the guidelines established under the debt management policy.

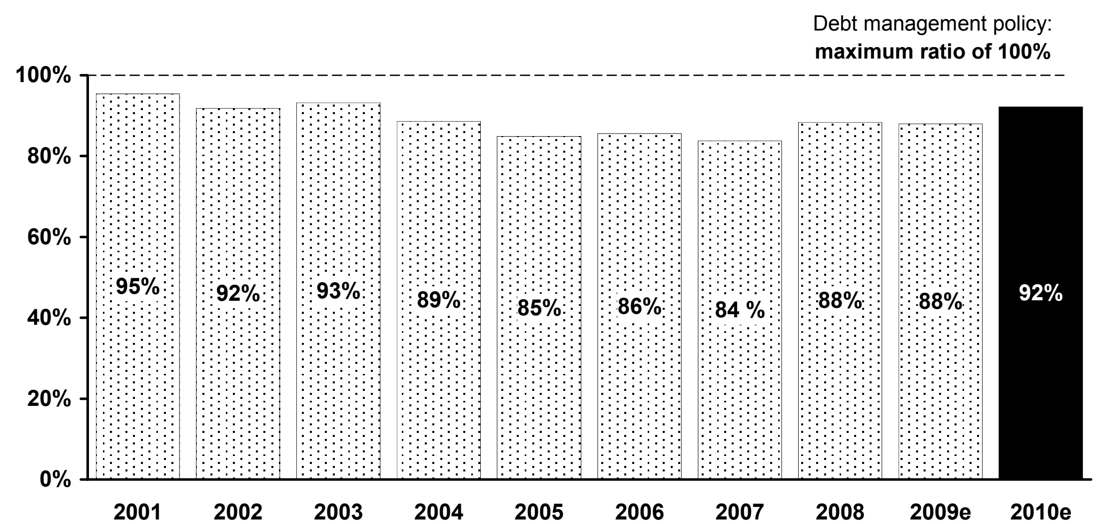
FINANCIAL PORTRAIT

Since the municipal merger of 2002, the city has instituted various financial and budgetary policies and frameworks. These "resources" were designed to ensure the sound management of public moneys and to provide short-, medium- and long-term improvements to the city's financial situation. This report describes the evolution of various financial criteria over the past 10 years and demonstrates how the city's financial situation has improved as a whole.

Decreased Net Direct and Indirect[1] Debt Burden

The debt management policy that has been in force since 2004 sets various criteria for guiding the city's debt-related activities. One such criterion is designed to cap direct and indirect debt at 100% of revenues from the city's Global Budget, excluding refinancing of the initial actuarial liability. A review of the data shows that, despite substantial growth in net debt of the Société de transport de Montréal,[2] this ratio still remains lower than 100%, at 92%.

Chart 5
Net Direct and Indirect Debt (Excluding Actuarial Liability), from 2001 to 2010 as a Percentage of Revenues
(As at December 31 of each year)



e: estimated.

[1] Indirect debt comprises debt from the city's accounting entities, which include the Société de transport de Montréal, the Société d'habitation et de développement de Montréal, the Société de développement de Montréal, Corporation Anjou 80 and Technoparc Saint-Laurent. The debt for 2005 has been adjusted in view of loan deferrals following the territorial reorganization. To balance out this special situation, we added $250 million to the debt of 2005. Debts in 2006 for the reconstituted municipalities were generally excluded from Montréal's debt. In other words, the reconstituted municipalities remain responsible for their respective debts.

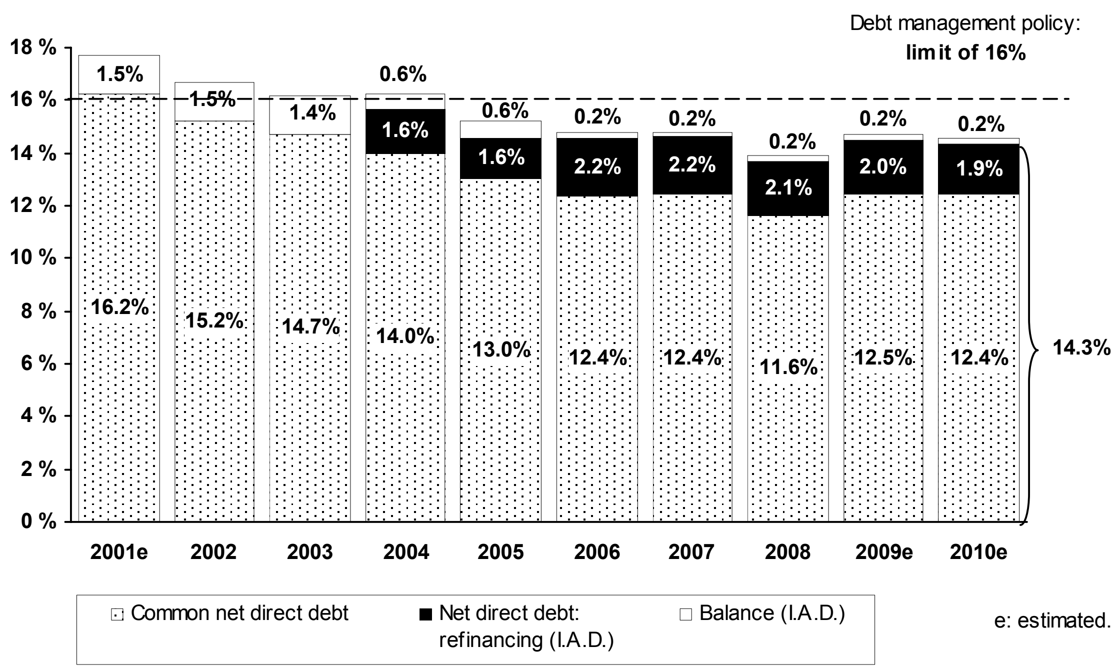
[2] Net debt of the Société de transport de Montréal is expected to rise from $164.9 million in 2001 to $534 million in 2010.

Relative Debt Service Burden

The following chart presents net debt service burden with respect to all expenditures. The city's debt management policy caps the relative debt service burden at 16% of all city expenditures. From 2003 to 2005, for example, the city refinanced the initial actuarial liability of five of its six retirement plans (managers, supervisors, public servants, firefighters and professional workers). This refinancing process served to increase funding costs. The increase has, however, been offset by a reduction in special contributions.

The net debt service cost in 2001 was 16.2% of all operating expenditures and financing. This ratio declined to 12.4% in the 2010 Budget. Even with the financial expenses for refinancing the initial actuarial liability, the total net debt service burden (14.3%) has been substantially reduced with respect to 2001.

Chart 6
Net Debt Service Cost as a Percentage of Expenditures and Financing from 2001 to 2010
(Budget data)



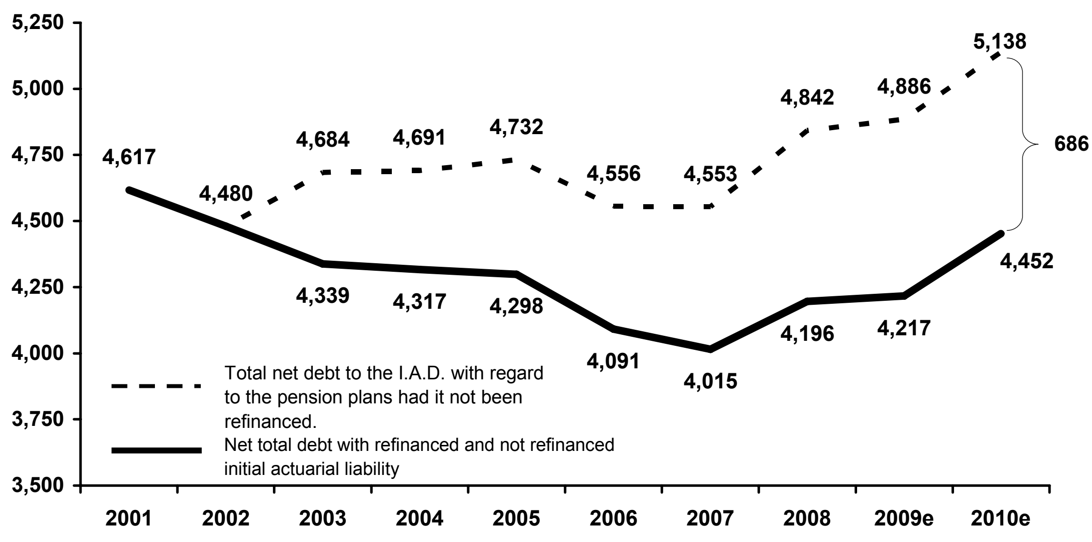
Improved Financial Results

As at December 31, 2001, the Ville de Montréal's net direct debt stood at $3 billion. The former city also had an initial actuarial liability of $1.6 billion with respect to its retirement plans, bringing the total to $4.6 billion.

One special feature of this initial actuarial liability is that it was scheduled to grow over the years until 2011, since special contributions that had been set aside were inadequate to pay the interest on this debt. The city's deployment of a strategy for refinancing this actuarial liability has largely served to rectify this situation and to improve Montréal's financial results by $686 million, primarily by:

- Reducing the initial actuarial liability by $240 million, through the cooperation of the Government of Québec, which has agreed to assume responsibility for this debt component.
- A gain of $446 million resulting from various aspects of this strategy, such as:
  - Freezing the amount of the initial actuarial liability, which has largely served to prevent future growth of this debt.
  - Modification of the repayment system, which made it possible to begin reimbursing the capital in 2004.
  - The financing structure and low interest rates.

Chart 7
Evolution of Net Direct Debt and Initial Actuarial Liability with and without the Refinancing Funding Strategy[3], 2001 to 2010
(Data as at December 31 of each year—in millions of dollars)



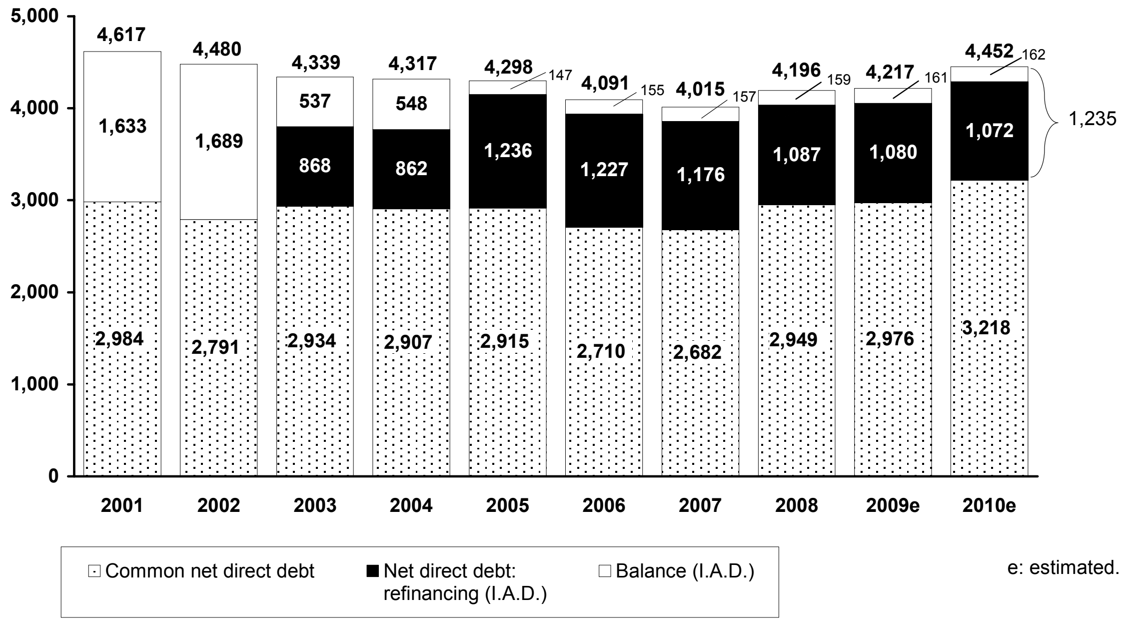
e: estimated.

3 The expenditures to be financed over the long term associated with the refinancing of the initial actuarial liability are not taken into account. In 2010, these expenditures hover around $52 million.

Indebtedness Under Control

Funded net direct debt (pertaining to loans to be repaid by the taxpayers) stood at $3.8 billion (including loans made in 2003 to refinance the initial actuarial liability) according to the city's financial statements for 2003 and 2004.[4] As the following chart illustrates, net direct debt and the initial actuarial liability have declined with respect to 2001. Since the time the initial actuarial liability was refinanced in 2003, it has dropped from $1.6 billion in 2001 to $1.1 billion in 2010. Net direct debt, including the initial actuarial liability, has also dropped overall and with respect to 2001, from $4.6 billion in 2001 to $4.5 billion in 2010.

Chart 8
Evolution of Net Direct Debt and Initial Acturial Liability (I.A.D.), 2001 to 2010
(Data as at December 31 of each year—in millions of dollars)



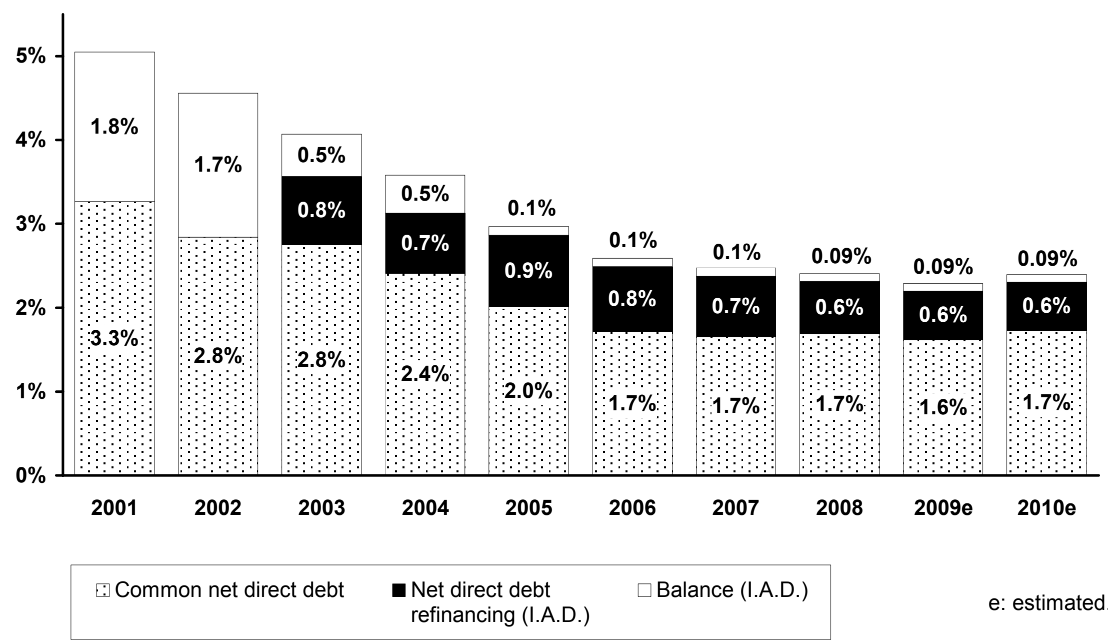
[4] Investment expenditures and financial activities to be funded over the long term are not considered in this section.

Direct Debt Burden in Terms of Assessed Property Value

The following chart illustrates the evolution of net direct debt in percentage terms with respect to the harmonized equivalent taxable assessment.[5] This chart reveals that the net direct debt burden is expected to drop from 3.3% in 2001 to 1.7% in 2010. Based on the refinancing of the initial actuarial liabilities of certain retirement plans, the net direct debt burden should stand at 2.3% in December of 2010. This decline is due to three key factors:

- change in the net direct debt, excluding refinancing of the initial actuarial liability;
- rise in property values throughout the city;
- Montréal's strategy for refinancing the initial actuarial liability.

Chart 9
Net Direct Debt and Initial Actuarial Liability as Percentages of the Harmonized Equivalent Taxable Assessment, 2001 to 2010
(As at December 31 of each year)



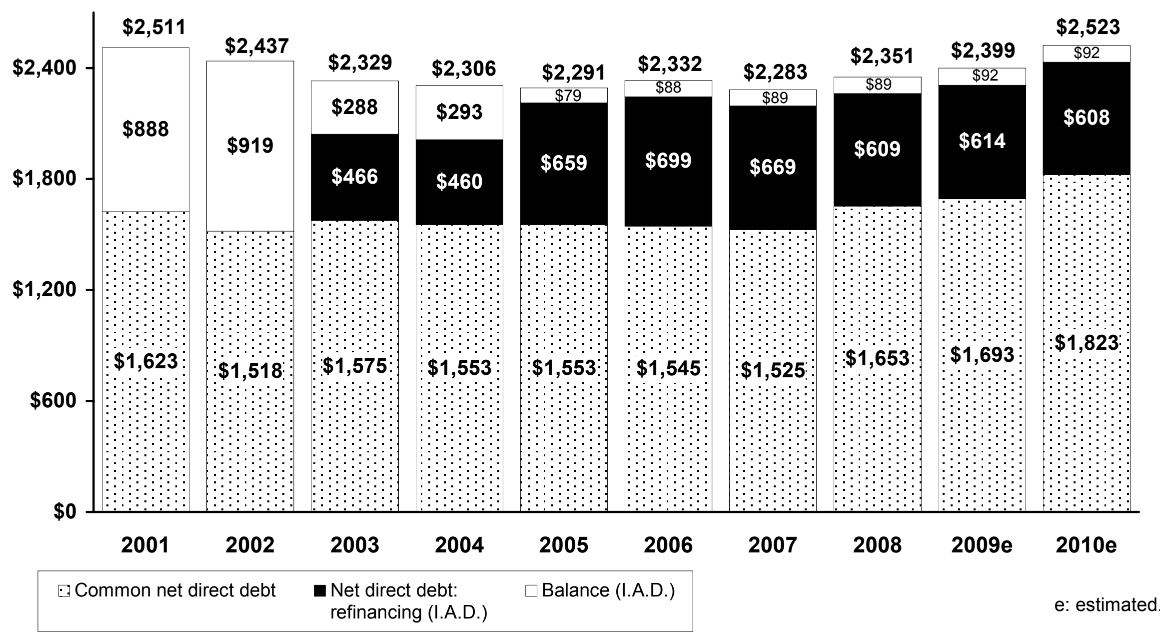
e: estimated.

5 The equivalent harmonized taxable value corresponds with the taxable value plus the adjusted value of non-taxable properties that are subject to payments in lieu of taxes. The equivalent taxable value is adjusted based on changes in the property market subsequent to the tabling of the assessment roll, to reflect the latest (harmonized) values.

Net Direct Debt per Resident

The following chart reveals that net direct debt per resident, including the refinancing of the initial actuarial liability, has increased slightly since 2001. It is expected to climb from $2,511 in 2001 to about $2,523 in 2010.

Chart 10
Net Direct Debt and Initial Actuarial Liability By Resident, 2001 to 2010
(As at December 31 of each year)

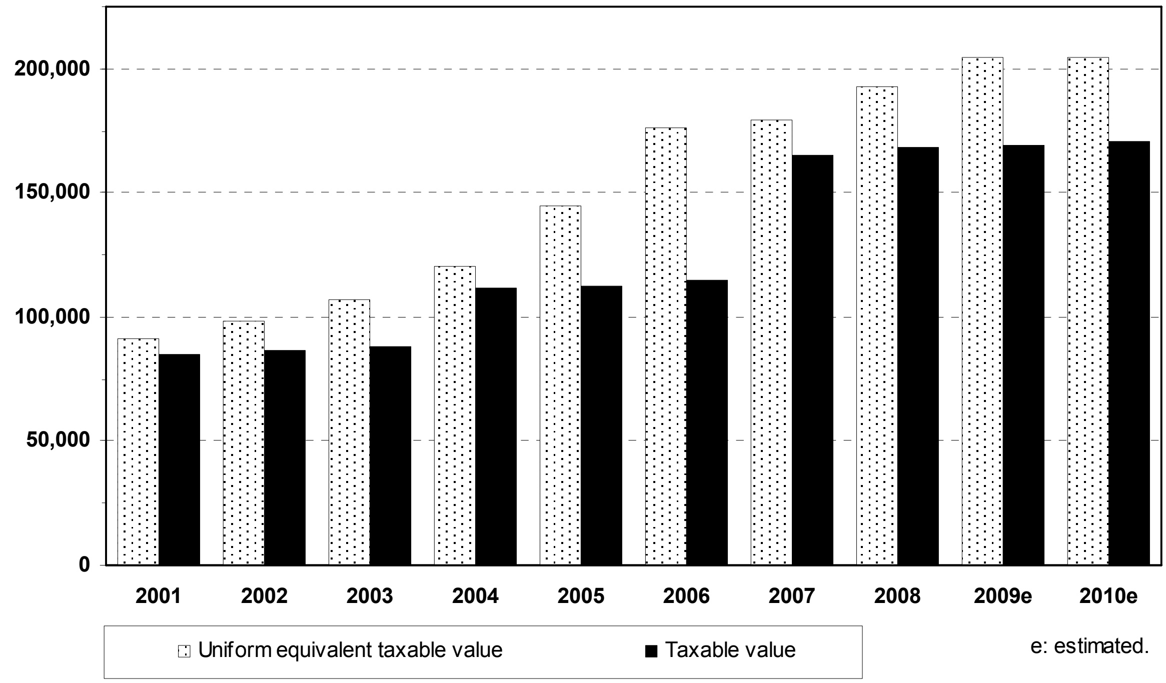


Rise in Assessed Property Value

The following chart illustrates the evolution of Montréal's property tax base. Since revenues of the different municipalities are essentially derived from property taxes, property value is a key indicator of such revenues.

There has been a substantial rise in taxable value and in the harmonized equivalent taxable value since 2001. There was, for example, growth of some 25% in the tax base between the 2001-2003 and the 2004-2006 three-year rolls. There was another 41% increase between the 2004-2006 and 2007-2010 rolls. The property market is displaying exceptional vitality, as illustrated by the newly tabled figures. The value of new properties and the value of improvements to existing ones have further contributed to this general growth in worth.

Chart 11
Tax Assessment and Harmonized Equivalent Tax Assessment, 2001 to 2010
(In millions of dollars)



Conclusion

Numerous factors have positively influenced the city's financial situation over the 2001 to 2010 period. The key ones have been:

- control over the level of indebtedness, while substantially boosting investment to keep infrastructure in good shape;
- refinancing of the initial actuarial liability and financial support for this effort from the Government of Québec;
- an economic situation that has enabled the city to benefit from low interest rates;
- a substantial rise in the property tax base, primarily resulting from implementation of the 2004-2006 and 2007-2010 Assessment Rolls and a real estate market that was particularly active in 2005 and 2006;
- implementation of a debt management policy serving to accelerate debt repayment (to generate a $169.7 million reduction from 2004 through late 2010.