Presented To:	Finance and Administration Committee
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Type:	Managers' Reports

Request for Decision

Debt Financing for Major Projects

Resolution

WHEREAS long term interest rates are currently at very attractive levels for borrowing and the City has a number of Council approved financing plans for initiatives and major projects approved in the 2017 - 2019 capital budgets that require debt in order to proceed;

THEREFORE BE IT RESOLVED that the City of Greater Sudbury delegates authority to the Executive Director of Finance, Assets and Fleet to secure debt up to $200 million in order to take advantage of the low interest environment to finance Council approved capital projects, as outlined in the report entitled "Debt Financing for Major Projects", from the General Manager of Corporate Services, presented at the Finance and Administration Committee meeting on August 13, 2019.

Signed By

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Digitally Signed Jul 30, 19

Financial Implications
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Recommended by the Department
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Recommended by the C.A.O.
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Relationship to the Strategic Plan / Health Impact Assessment

This report relates to Council's Strategic Plan objective of Economic Capacity and Investment Readiness.

Report Summary

Current long term interest rates remain historically low. Some forecasts call for steady increase in interest over the next few years. Staff will be issuing an RFP to secure debt to test the environment regarding interest rates currently available in the marketplace.

Financial Implications

Until the projects require funding, the differential between the borrowing interest rate and the investment interest rate will be funded from the annual budgeted debt repayment amounts totalling approximately $4 million.

Background

There are a number of initiatives that Council approved over the last three years that require debt financing in order to proceed with the implementation. These include the Arena/Events Centre, the Junction, MR35, playground revitalization, bridge and culvert rehabilitation and a grant to Place des Arts. Some of these projects are currently at the design stage and the actual construction may be a year or two away.

The current low interest rate environment provides an opportunity for the City to borrow the necessary funds for these projects in advance of construction in order to secure a very favourable rate. Infrastructure Ontario is the benchmark used by the City to gauge the current interest rate environment. The 30-year term currently offered by Infrastructure Ontario is 2.83%. Staff would go out to the capital markets to potentially secure a more favourable rate. The City's current public debt rating of AA stable would be viewed by financial institutions as a sign of financial stability, which could result in lower interest rates. Refer to Appendix I – Infrastructure Ontario Rates.

Differential in Budget Interest Rates and Current Rates

The two large projects, Arena/Events Centre and the Junction, had business cases developed based on a 4.0% interest rate over 30 years. For the Arena/Events Centre, the annual debt repayment budgeted was $5.2 million. Based on the City's ability to borrow at the current rate, the annual debt repayment would be $4.5 million. Securing a low interest rate now would eliminate interest rate risk in borrowing for these major projects.

Options Available and Risks

The City has a number of options available as a result of the AA stable rating.

1) The City may borrow funds today and secure a firm rate for 30 years for projects that will require funding within the next year or two. There is a minimal risk that interest rates will decline further and the City would lose out on a lower interest rate. The consensus amongst financial institutions is that the yield curve will normalize over time resulting in higher long term interest rates even if the Bank of Canada overnight lending rate decreases.
2) The City may secure funding by forward booking an interest rate. The rate could be set now for funds being borrowed ten months from now. Based on estimations from financial institutions, the premium associated with forward booking the rate ten months in the future could range from 10 – 15 basis points (0.1% – 0.15%). The benefit of forwarding booking a rate is that the City would not be making debt repayments until funding of the projects takes place in ten months from now. The drawback is that the City will be paying the higher

interest rate for the entire 30 year term. The RFP will have both options included for the proponents to bid.

3) If the results of the RFP do not yield the desired effect, the City may engage a financial institution to assist the City in issuing debentures. This would potentially result in additional costs and administration burden on City staff. The risk is that the debenture issue may not sell out and the debenture would have to be repriced causing additional costs to the City.

Projects with Approved Debt Financing Components

The following capital projects approved through the 2017 – 2019 capital budgets have a financing plan that incorporates debt:

Arena/Events Centre	$90.0 million
The Junction	$68.0 million
Municipal Road 35	$30.8 million
Bridge & Culverts	$6.9 million
Place des Arts	$5.0 million
Playground Revitalization	$2.3 million
McNaughton Terrace Treatment Facility	$2.2 million
Total	**$205.2 million**

In the 2020 Capital Budget, funding of additional initiatives may also require debt financing.

City's Debt Repayment

Currently the City's debt repayments as a percentage of the City's own source revenues is 2.5%. City Council has approved a debt repayment limit of 10% of own source revenues which provides the City with additional debt borrowing capacity of between $550 million and $650 million depending on borrowing interest rates. Securing the $200 million of debt would increase the debt repayment as a percentage of own source revenue to 5.0%; well within Council's imposed limit of 10%.

Delegated Authority

Capital markets can be volatile and reactive to events such as: economy news or forecasts, geopolitical uncertainty and government monetary policy. As a result staff is requesting that Council provides delegated authority to the Executive Director of Finance, Assets and Fleet to secure debt to take advantage of optimum interest rates for borrowing. Banks and other financial institutions may only provide a limited amount of time to take advantage of their proposed rate through a Request for Proposal. There may not be sufficient time to seek Council's approval in securing debt at the proposed interest rate.

How to Make Use of these Funds

Although the funds would not be required immediately, they could be invested in financial instruments. The City currently sets funds aside in a High Interest Savings Account (HISA). The funds in this account receive a 2.6% interest rate. This rate is linked to the Canadian Bank Prime Rate. Should the Prime Rate fall, so will the interest on the HISA. The current guidance from the Bank of Canada indicates that no interest rate change is expected in the near future. The HISA account has no ceiling on funds being deposited. The HISA also has one day settlement, which means the funds are fully liquid.

The differential from the borrowing interest rate (indicated by Infrastructure Ontario) and the investment rate (currently approximately 0.23%) can be easily funded from the budgeted debt repayment amounts in excess of $4.0 million currently in the 2019 Operating Budget. For every $100 million borrowed, the current differential of the annual debt requirement compared to the investment income from the HISA account is $230,000.

Interest Rate Forecasts

Economists and financial analysts forecast for the Bank of Canada rate, range from a quarter point rate increase in the first quarter of 2020, to no rate increase until 2021.

However, the financial institutions are projecting the Canadian 30 year bond yield to increase from where they are currently. Although, little movement is expected in the Bank of Canada overnight lending rate, it is anticipated that the yield curve will normalize over time causing the 30 year bond rate to increase. The City's borrowing rate would be impacted by the movement on the Canada 30 year bond. Refer to Appendix II, which reflects the projections for the Canada bonds from a number of financial institutions.

As a result, the current interest rate environment provides the City with an opportunity to borrow for major projects at an extremely favourable rate in advance of requiring the funds.

Summary

The current low interest environment provides the City with an opportunity to secure funding now for future projects and eliminates the risk of borrowing at higher interest rates. Providing delegated authority to the Executive Director of Finance, Assets and Fleet allows the City to take advantage of the best available rate and reduces the risk of securing debt in an increasing interest rate environment in the future.

Appendix I – Infrastructure Ontario Lending Rates as of July 30, 2019

	Amortizer
5Y	2.17%
10Y	2.36%
15Y	2.54%
20Y	2.69%
25Y	2.78%
30Y	2.83%

FINANCIAL MARKET FORECASTS

July 12, 2019

Interest rates (%, end of quarter)

	Actual						Forecast						Actual		Forecast	
	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4	2017	2018	2019	2020
Canada																
Overnight	1.25	1.25	1.50	1.75	1.75	1.75	1.75	1.75	1.50	1.50	1.50	1.50	1.00	1.75	1.75	1.50
Three-month	1.10	1.26	1.59	1.64	1.67	1.66	1.65	1.60	1.40	1.40	1.40	1.40	1.06	1.64	1.60	1.40
Two-year	1.78	1.91	2.21	1.86	1.55	1.47	1.60	1.45	1.35	1.40	1.45	1.50	1.69	1.86	1.45	1.50
Five-year	1.97	2.07	2.34	1.89	1.52	1.39	1.60	1.55	1.45	1.50	1.55	1.65	1.87	1.89	1.55	1.65
10-year	2.09	2.17	2.43	1.97	1.62	1.47	1.70	1.70	1.60	1.60	1.70	1.80	2.04	1.97	1.70	1.80
30-year	2.23	2.20	2.42	2.18	1.89	1.69	1.85	1.85	1.90	1.95	2.00	2.00	2.27	2.18	1.85	2.00
Yield curve (10s-2s)	31	26	22	11	7	0	10	25	25	20	25	30	35	11	25	30
United States																
Fed funds*	1.75	2.00	2.25	2.50	2.50	2.50	2.00	2.00	2.00	2.00	2.00	2.00	1.50	2.50	2.00	2.00
Three-month	1.73	1.93	2.19	2.45	2.40	2.12	1.90	1.90	1.90	1.90	1.90	1.90	1.39	2.45	1.90	1.90
Two-year	2.27	2.52	2.81	2.48	2.27	1.75	1.85	1.90	1.95	2.00	2.10	2.15	1.89	2.48	1.90	2.15
Five-year	2.56	2.73	2.94	2.51	2.23	1.76	1.85	1.95	2.00	2.10	2.20	2.30	2.20	2.51	1.95	2.30
10-year	2.74	2.85	3.05	2.69	2.41	2.00	2.05	2.15	2.25	2.30	2.35	2.45	2.40	2.69	2.15	2.45
30-year	2.97	2.98	3.19	3.02	2.81	2.52	2.55	2.60	2.65	2.70	2.75	2.80	2.74	3.02	2.60	2.80
Yield curve (10s-2s)	47	33	24	21	14	25	20	25	30	30	25	30	51	21	25	30
Yield spreads																
Three-month T-bills	-0.63	-0.67	-0.60	-0.81	-0.73	-0.46	-0.25	-0.30	-0.50	-0.50	-0.50	-0.50	-0.33	-0.81	-0.30	-0.50
Two-year	-0.49	-0.61	-0.60	-0.62	-0.72	-0.28	-0.25	-0.45	-0.60	-0.60	-0.65	-0.65	-0.20	-0.62	-0.45	-0.65
Five-year	-0.59	-0.66	-0.60	-0.62	-0.71	-0.37	-0.25	-0.40	-0.55	-0.60	-0.65	-0.65	-0.33	-0.62	-0.40	-0.65
10-year	-0.65	-0.68	-0.62	-0.72	-0.79	-0.53	-0.35	-0.45	-0.65	-0.70	-0.65	-0.65	-0.36	-0.72	-0.45	-0.65
30-year	-0.74	-0.78	-0.77	-0.84	-0.92	-0.83	-0.70	-0.75	-0.75	-0.75	-0.75	-0.80	-0.47	-0.84	-0.75	-0.80

Note: Interest Rates are end of period rates. * Top of 25 basis point range

Exchange rates (end of quarter)

	Actual						Forecast						Actual		Forecast	
	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4	2017	2018	2019	2020
AUD/USD	0.77	0.74	0.72	0.71	0.71	0.70	0.69	0.68	0.67	0.67	0.66	0.66	0.78	0.71	0.68	0.66
USD/CAD	1.29	1.31	1.29	1.36	1.33	1.31	1.28	1.29	1.30	1.31	1.32	1.33	1.26	1.36	1.29	1.33
EUR/USD	1.23	1.17	1.16	1.15	1.12	1.14	1.10	1.12	1.14	1.15	1.15	1.18	1.20	1.15	1.12	1.18
USD/JPY	106.3	110.8	113.7	109.7	110.9	107.9	111.0	113.0	115.0	114.0	113.0	112.0	112.7	109.7	113.0	112.0
USD/CHF	0.95	0.99	0.98	0.98	1.00	0.98	1.02	1.01	1.00	1.00	1.01	0.98	0.97	0.98	1.01	0.98
GBP/USD	1.40	1.32	1.30	1.28	1.30	1.27	1.25	1.27	1.30	1.31	1.31	1.34	1.35	1.28	1.27	1.34

Interest Rate Outlook

	2018				2019				2020			
	Q1	Q2	Q3	Q4	Q1	Q2*	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Canada												
Overnight Target Rate	1.25	1.25	1.50	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
3-mth T-Bill Rate	1.10	1.26	1.59	1.64	1.67	1.66	1.65	1.65	1.65	1.65	1.65	1.65
2-yr Govt. Bond Yield	1.77	1.91	2.21	1.86	1.55	1.38	1.50	1.55	1.60	1.65	1.70	1.75
5-yr Govt. Bond Yield	1.96	2.06	2.33	1.88	1.52	1.33	1.50	1.55	1.65	1.70	1.75	1.80
10-yr Govt. Bond Yield	2.09	2.17	2.42	1.96	1.62	1.44	1.55	1.65	1.75	1.85	1.90	1.95
30-yr Govt. Bond Yield	2.23	2.20	2.42	2.18	1.89	1.70	1.80	1.90	2.00	2.10	2.15	2.20
10-yr-2-yr Govt Spread	0.32	0.26	0.21	0.10	0.07	0.05	0.05	0.10	0.15	0.20	0.20	0.20
U.S.												
Fed Funds Target Rate	1.75	2.00	2.25	2.50	2.50	2.50	2.25	2.00	2.00	2.00	2.00	2.00
3-mth T-Bill Rate	1.70	1.89	2.15	2.40	2.35	2.14	1.98	1.85	1.85	1.85	1.85	1.85
2-yr Govt. Bond Yield	2.27	2.52	2.81	2.48	2.27	1.84	1.95	2.00	2.05	2.10	2.15	2.20
5-yr Govt. Bond Yield	2.56	2.73	2.94	2.51	2.23	1.83	2.00	2.10	2.20	2.30	2.35	2.40
10-yr Govt. Bond Yield	2.74	2.85	3.05	2.69	2.41	2.08	2.20	2.30	2.40	2.45	2.50	2.55
30-yr Govt. Bond Yield	2.97	2.98	3.19	3.02	2.81	2.59	2.45	2.55	2.65	2.70	2.75	2.80
10-yr-2-yr Govt Spread	0.47	0.33	0.24	0.21	0.14	0.24	0.25	0.30	0.35	0.35	0.35	0.35
Canada-U.S. Spreads												
Can - U.S. T-Bill Spread	-0.60	-0.63	-0.56	-0.76	-0.68	-0.47	-0.33	-0.20	-0.20	-0.20	-0.20	-0.20
Can - U.S. 10-Year Bond Spread	-0.65	-0.68	-0.63	-0.73	-0.79	-0.65	-0.65	-0.65	-0.65	-0.60	-0.60	-0.60

F: Forecast by TD Bank Group as at June 2019. All forecasts are end-of-period.
Source: Bloomberg, Bank of Canada, Federal Reserve, TD Economics. * Spot rate as at June 14, 2019 with the exception of policy rates.

United States						
Quarters	Fed Fund	3 Mth Bill	2YR	5YR	10YR	30YR
07/03/19	2.50	2.21	1.76	1.74	1.95	2.47
Q3	2.25	1.93	1.72	1.78	2.05	2.58
Q4	2.00	1.81	1.60	1.67	1.97	2.53
Q1/20	2.00	1.81	1.75	1.84	2.13	2.65
Q2	2.00	1.81	1.90	2.02	2.30	2.79
Q3	2.00	1.81	2.00	2.25	2.46	2.93
Q4	2.00	1.81	2.02	2.28	2.49	2.95

Canada						
Quarters	Overnight	3 Mth Bill	2YR	5YR	10YR	30YR
07/03/19	1.75	1.66	1.50	1.42	1.46	1.66
Q3	1.75	1.68	1.43	1.39	1.45	1.66
Q4	1.75	1.71	1.55	1.46	1.56	1.74
Q1/20	1.75	1.71	1.71	1.73	1.84	1.97
Q2	1.75	1.71	1.78	1.81	2.04	2.14
Q3	1.75	1.89	2.07	2.18	2.28	2.31
Q4	2.00	1.96	2.10	2.18	2.30	2.33

Regards
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MARKET CALL

- With the US economy looking like its slowing down, and with downside risks from tariffs rising, Fed members have started talking about the possibility of cutting interest rates. And with core PCE inflation likely to remain below 2% through the end of the year (see pages 6-7), there's scope for them to do so. Assuming no near-term resolution to the US-China trade dispute, we have brought forward and added to our previous forecast for Fed rate cuts. We now expect two, in Q4 2019 and Q1 2020.
- While we're likely to get some better news on the Canadian economy over the remainder of 2019 (see pages 3-5), the BoC is still relying heavily on exports and business investment to drive the economy by 2020. However, continued global trade uncertainties, combined with a temporary appreciation in the C$ as the Fed cuts interest rates, could see the BoC reluctantly join in and reduce rates by 25bp in Q2 2020.
- Financial markets may be correct in assuming that interest rate cuts are coming. However, they may be incorrect in just how many will be needed to stabilize growth and inflation. Long-term interest rates appear to be pricing in a much more dire outlook than the 1½% growth rates we forecast for next year. As such, there's scope for 10-year yields to rise even as central banks cut at the short end.

INTEREST & FOREIGN EXCHANGE RATES

		2019			2020			
END OF PERIOD:		**12-Jun**	**Sep**	**Dec**	**Mar**	**Jun**	**Sep**	**Dec**
CDA	Overnight target rate	1.75	1.75	1.75	1.75	1.50	1.50	1.50
	98-Day Treasury Bills	1.67	1.70	1.70	1.60	1.40	1.45	1.45
	2-Year Gov't Bond	1.46	1.60	1.60	1.50	1.40	1.40	1.45
	10-Year Gov't Bond	1.51	1.75	1.85	1.70	1.65	1.50	1.60
	30-Year Gov't Bond	1.76	1.95	2.00	2.05	1.95	1.90	1.85
U.S.	Federal Funds Rate	2.375	2.375	2.125	1.875	1.875	1.875	1.875
	91-Day Treasury Bills	2.25	2.35	2.13	1.80	1.70	1.80	1.88
	2-Year Gov't Note	1.88	2.05	2.00	1.90	1.70	1.90	2.00
	10-Year Gov't Note	2.13	2.35	2.45	2.20	2.20	2.30	2.40
	30-Year Gov't Bond	2.62	2.75	2.75	2.70	2.65	2.65	2.60
Canada - US T-Bill Spread		-0.59	-0.65	-0.43	-0.20	-0.30	-0.35	-0.43
Canada - US 10-Year Bond Spread		-0.62	-0.60	-0.60	-0.50	-0.55	-0.80	-0.80
Canada Yield Curve (10-Year — 2-Year)		0.05	0.15	0.25	0.20	0.25	0.10	0.15
US Yield Curve (10-Year — 2-Year)		0.25	0.30	0.45	0.30	0.50	0.40	0.40
EXCHANGE RATES	CADUSD	0.75	0.76	0.75	0.75	0.74	0.74	0.72
	USDCAD	1.33	1.31	1.34	1.34	1.35	1.36	1.38
	USDJPY	108	106	105	104	103	101	100
	EURUSD	1.13	1.16	1.18	1.20	1.23	1.23	1.24
	GBPUSD	1.27	1.33	1.37	1.41	1.46	1.46	1.46
	AUDUSD	0.70	0.70	0.71	0.74	0.76	0.78	0.78
	USDCHF	0.99	0.97	0.96	0.94	0.93	0.93	0.94
	USDBRL	3.86	3.65	3.80	3.85	3.95	3.90	3.80
	USDMXN	19.7	20.1	19.9	20.1	20.4	20.6	20.7