

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	<u>\$2.2 million</u>
Total	<u>\$205.2 million</u>

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.