

City Council

Type of Decision									
Meeting Date	March 10, 2020				Report Date	March 6, 2020			
Decision Requested		Yes	X	No	Priority	X	High		Low
	Direction Only				Type of Meeting	X	Open		Closed

Report Title
Debenture 2020

Resolution	Relationship to the Strategic Plan/Health Impact Assessment
For Information Only	This report relates to Council's Strategic Plan objective of Economic Capacity and Investment Readiness
<input type="checkbox"/> Resolution Continued	<input checked="" type="checkbox"/> Background Attached

Report Summary

This report provides an update on the process and results of the City's recent financing. The City has issued, subject to the confirmation of By-law 2020-61, a 30 year debenture in the amount of \$200 million which was priced and sold on February 25, 2020 at a rate of 2.416%.

Financial Implications

The rate of 2.416% is lower than the rates when the capital budget was established (3-4%). The repayment amount for the debenture is approximately \$2.75 million less than the amounts identified in the approval of the capital projects.

Report Prepared By


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Division Review

Recommended by the Department


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Financial Implications


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Recommended by the C.A.O.


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Background

At the August 13, 2019 Finance and Administration Committee meeting the Committee reviewed the Debt Financing for Major Projects report. The report provided Committee with the option to expedite the issuance of debt for several initiatives previously approved in the 2017-2019 budgets. The low interest rate environment provided an opportunity for the City to borrow funds in advance of construction at a very favourable rate. The Committee approved Resolution FA2019-53 which included:

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.

The following projects approved in prior year budgets were anticipated to be funded, at least in part, with debt financing. These projects formed the basis for recommending the \$200M debt amount approved last August, but Council retains discretion to change the timing, amount or scope of these projects:

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>

Further, the nature of these assets include an expectation that they have long useful lives. Therefore, this collection of capital projects not only require debt financing, but they also are expected to support the community for decades, making a 30-year term for debt repayment a reasonable basis for securing debt financing.

In order to stay within the delegated authority of \$200 million, the financing plan for Place des Arts anticipates funding will occur from the municipality's reserves. An annual allocation in the budget, which started in 2017, replenishes the reserve to account for the Place des Arts funding.

Financing Options Explored

Staff reviewed several options both traditional financing from banks and financial institutions and issuing our own debt through a variety of available debt instruments.

- 1) **CPS19-228-Debt Financing** – staff issued a Request for Proposals that closed December 11, 2019. It assessed several factors, including experience in municipal lending, terms and conditions (including pre-payment options, penalties for early payment, cost of financing and requested additional options of securing a rate in October 2020 or securing \$100 million in December 2019 and \$100 million in October 2020 by forward booking a rate). The City received only one submission and it was found to be non-compliant as it did not include traditional debt financing. While the RFP was open, potential bidders suggested the corporation consider a debenture issue. Staff recognized this as a viable and traditional approach for municipal debt financing but wanted to ensure all traditional loan avenues were reviewed rather than include that as an addendum to the RFP.
- 2) **Infrastructure Ontario (IO)** – In January 2020, Staff discussed the application process and parameters with the area representative for IO. Due to the loan request being in excess of \$20 Million, the application would have required IO board approval which was not available until late March and there was concern that a delay would impact the final rate secured. Staff started the approval process and continued to correspond with IO on indicative rates as other alternatives were reviewed. Indicative rates from IO were 2.83% the date the RFP closed and ranged from 2.83% January 11 to a low of 2.50% on the date of the debenture closing.
- 3) **Debenture** – Staff discussed other financing options with five large Canadian banks and their capital markets personnel. The capital market teams felt that the market would be amenable to a debenture offering by the City and provided an assessment as to where the market would price a debenture issuance. Staff reviewed the experience of the firms and decided to continue discussions with National Bank Financial and Bank of Montreal.

Staff continued to compare the capital market rates with those of the Infrastructure Ontario's lending program. Staff was able to obtain comfort that the rates through the capital markets would be more favourable in comparison to those of IO. The ability to secure financing through the capital markets more quickly with settlement in weeks versus months for IO also was a factor in the choice to issue debentures.

Debenture Process

In order to proceed with a debenture issuance external legal counsel was required to review the authorizing documents to ensure they would be able to provide their legal opinion that the Debenture By-law has been properly passed and is within the legal powers of the City. On February 19, external legal counsel confirmed the City's authorizing documents were in order which allowed the issue to proceed. Discussions with the fiscal agent syndicate continued during this time to assess market conditions, investor demand, pricing, and supply including recent and potential provincial and municipal debt issues.

The issue was marketed by the syndicate with National Bank Financial acting as lead agent.

The issue was priced and sold on February 25, 2020.

Interest Rate

The interest rate of 2.416% is the sum of the following:

Bank of Canada – 2048 bond rate -	1.316%
Province of Ontario 2050 bond premium	0.760%
City of Sudbury premium	<u>0.330%</u>
Final Interest Rate to Investors (sum of above)	2.416%

The underwriting fee on an issue this large was 0.07% or \$1.4 million. The price of the issue resulted in an "all-in rate" of 2.449%.

The issue was over-subscribed, with wide placement and distribution of debentures to 26 accounts across Canada and the US. The favourable rate was due to international economic conditions and the lack of competition in the municipal market.

Staff continue to discuss market conditions with the syndicate and have confirmed that since the City issuance there has not been a syndicated government debt issuance. Some provinces have attempted to access the debt markets and there is interest, but they have been unable to execute a transaction. In addition some corporate issuers have issued debt, but at a higher yield than would be considered to be normal.

Sinking Fund Contributions

A sinking fund is a method of building funds to repay a debt obligation. Based on a defined period (in this case, 30 years), and on an assumed rate of return from the funds, a sinking fund builds a balance over time that enables the debt to be repaid. The Municipal Act prescribes the use of sinking funds for municipal bond obligations.

When a sinking fund debenture is issued, an annual contribution is required to be made by the City to a sinking fund per Municipal Act, 2001 (section 409). The annual contributions which together with interest earnings derived from the investment of these funds, will accumulate to an amount that will be sufficient to pay the debentures principal balance owing at maturity in 2050. The sinking fund investments will be held in a separate bank or investment account and be reported annually in the financial statements.

In discussions with our investment advisor it was determined that a long-term interest rate of 3.0% for the earnings assumption for the sinking fund account would be reasonable. The required annual contribution is \$4,203,851.86 with the first contribution due March 12, 2021. Current investment grade returns are lower than the 3% interest rate and it would be prudent in the present environment to commence even a partial payment prior to March 12, 2021. The sinking fund investments will follow the current investment management policy for the City.

When the sinking fund balance of this, or any future debenture issue is estimated to be enough to pay the principal amount of the debenture issue at maturity, Council may reduce the annual levy contribution in accordance with Section 409(9) of the Municipal Act, 2001. This would not be expected to occur until far in the future. In addition, if the balance of the sinking fund is in excess of the principal amount of the debenture at the maturity date in 2050, that excess may be transferred to the general fund in accordance with Section 409 of the Municipal Act.

Financial Impact

Overall Result

The results of this debt issue require lower repayment amounts than what was estimated in previous budgets. The actual interest rate payable of 2.416% is lower than the range of interest rates anticipated when the capital budget was established (i.e. 3%-4%).

This means the actual annual debt repayment amount is approximately \$2.75M lower than the amount included in the current, approved budget.

Creating a Sinking Fund

In 2020, the City will be required to make the first interest payment in September \$2.416 million and will accrued the portion of the March 2021 payment that relates to 2020 \$1.447 million. The total interest amount for 2020 is \$3.863 million. There is no need for a sinking fund contribution until March 2021. The 2020 budgeted debt repayment amount is \$8.246 million leaving a surplus of \$4.382 million. This surplus can be used to fund the \$1.4 million fee incurred in issuing the debentures and to commence funding the sinking fund.

Immediate Use of these Funds

Of the \$200M debt, approximately \$30 million are required in 2020 to fund current capital project obligations. For the remaining funds, they can be invested until required. The City will set funds aside in the High Interest Savings Account (HISA), which currently receives a 2.10% interest rate linked to the Canadian Bank Prime Rate. Should the Prime Rate rise or fall, so will the interest on the HISA. The uncertainty in the global financial markets has recently dropped the rate on this account from 2.6% on March 4 to the current rate of 2.1%. The HISA account has no ceiling on funds being deposited. The HISA also has one day settlement, which means the funds are fully liquid.

Based on the current interest rate received on the HISA, the City will earn \$11,500 per day based on the full \$200 million being initially set aside. If the Bank of Canada were to decrease interest rates, each quarter percentage change in the rate would translate into a difference of \$1,400 per day. If the \$200 million remained in the HISA and rates stayed the same as current the earnings would be approximately \$3.3 million for 2020, this amount will decrease as the funds are required to fulfill the capital project obligations.

Summary

The City was able to successfully place the debentures at a favourable rate compared to the rates presented at the August 13, 2019 Finance and Administration meeting and has provided relief to future budgets based on the lower rates achieved.

Relevant Links for Further Information:

1. Finance and Administration meeting of August 13, 2019

Staff report: Debt Financing for Major Projects

<https://agendasonline.greatersudbury.ca/index.cfm?pg=agenda&action=navigator&id=1370&itemid=17196&lang=en>