CITY OF VANCOUVER

ADMINISTRATIVE REPORT

Report Date:	September 5, 2017
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Meeting Date:	September 20, 2017

TO: Standing Committee on City Finance and Services

FROM: Director of Finance

SUBJECT: Debenture Program 2017

RECOMMENDATION

A. THAT Council authorize the issuance of up to $85,000,000 City of Vancouver debentures, utilizing borrowing authorities approved as part of the 2015, 2016, and 2017 Capital Budgets as follows:

Waterworks	$ 2,500,000
Sewers & Drainage	$ 40,000,000
Water & Sewer Connections	$ 1,000,000
Parks	$ 2,000,000
Recreation and Exhibition Facilities	$ 6,000,000
Public Safety Facilities	$ 1,500,000
Streets and Bridge Infrastructure	$ 15,000,000
Street Lighting, Traffic Signals, and Communication Systems	$ 7,500,000
Community Facilities	$ 3,500,000
Civic Facilities and Infrastructure	$ 6,000,000
	$ 85,000,000

B. THAT, until the borrowing authorities established pursuant to Recommendation A are exercised, the Director of Finance, in consultation with the Mayor, the Chair of the City Finance and Services Committee, and the City Manager, or a majority of them, be empowered to act and instruct the City's Fiscal Agent to proceed with the issuance of the debentures, and to set the interest rate, price, and other terms and conditions on which the debentures will be issued by the City.

It should be noted that once the Director of Finance instructs the Fiscal Agent to offer the debentures in the public market, Council will be required to enact the appropriate borrowing by-law to authorize issuance of the debentures.

REPORT SUMMARY

The purpose of this report is to seek Council's authorization for the Director of Finance to issue up to $85,000,000 City of Vancouver debentures to finance the City's capital expenditure program.

The borrowing authorities as outlined in this report were established in the 2015-2018 Capital Plan through Council and electorate approval and the requirement for debenture funding approved by Council as part of the 2015, 2016, and 2017 Capital Budgets. Funding for the debt servicing charges (principal and interest) arising from the proposed borrowing will be provided in the annual Operating and Utility Budgets. As the final step in the process, the Director of Finance is seeking authority to exercise these authorities to finance the capital expenditure program.

COUNCIL AUTHORITY/PREVIOUS DECISIONS

It has been Council practice to fund capital expenditures for the waterworks, sewerage & drainage and energy utility systems from debenture borrowing. As part of the City's debt management strategy, commencing in the 2012-2014 Capital Plan, the water utility is in the process of transitioning its infrastructure lifecycle replacement program from debt financing to pay-as-you-go over two Capital Plans. The transition will be completed within the 2015-2018 Capital Plan. The balance of capital expenditures is funded from a combination of debenture borrowing, direct contributions from the annual Operating Budget (Capital from Revenue), Development Cost Levies and Community Amenity Contributions from developers, special-purpose reserves, internal loans, fees and levies collected from property owners, and contributions from senior governments and other funding partners.

Section 242 of the *Vancouver Charter* gives Council the authority to borrow funds for the construction, installation, maintenance, replacement, repair and regulation of waterworks, sewerage & drainage and energy utility systems without the assent of the electorate. Section 245 requires that the borrowing authority for all other purposes be established through the electorate's approval of a borrowing plebiscite.

The requirement to borrow funds to finance capital expenditures is established by Council at the time of the approval of the annual capital budget and through special approvals. Borrowed funds are generally paid back over 10 years to ensure that a systematic borrowing program can be administered, that outstanding debt does not accumulate to unacceptable levels and that annual debt servicing charges (principal and interest) are maintained at a level that does not put undue pressure on the operating budget.

Section 247 A of the *Vancouver Charter* requires that full provision of annual debt servicing charges (principal and interest) be made in the annual operating budget. This ensures that debenture holders are paid the interest component at the prescribed rate and time and that sufficient funding is available to retire the obligation at maturity.

As a pre-condition to an external debenture issue, Council authorizes the Director of Finance to set the interest rate, price and other terms and conditions on which the debentures will be issued, including the power to instruct the City's Fiscal Agent to proceed with the issue. In doing so, Council commits itself to follow through with the debenture issue and enact the appropriate borrowing by-law after the debentures are sold.

CITY MANAGER'S/GENERAL MANAGER'S COMMENTS

The City Manager RECOMMENDS approval of the foregoing.

REPORT

Background/Context

The City is the only municipality in British Columbia that manages its own borrowing program outside of the Municipal Finance Authority of British Columbia (MFABC). Pursuant to Council's authority as stipulated in the *Vancouver Charter*, the City borrows in its own name and manages its debenture portfolio with full autonomy over the timing, amounts, and terms and conditions of the debenture issues, and management of the sinking funds accumulated against City of Vancouver debentures.

The City's credit ratings continue to be among the best municipal ratings in Canada - AAA (stable) by Moody's Investors Service and AAA (stable) by Standard & Poor's Ratings Services compared to the ratings of many Canadian municipalities, making City of Vancouver debentures an attractive investment in both domestic and international markets. With respect to market access, the City has enjoyed the same level as the MFABC with no material difference in pricing.

Given the City's record of a strong financial and liquidity position, the timing for debenture issuance is most often driven by capital market conditions such as global risk appetite, interest rates, and investors' demand. In recent years, the City has been accessing the market annually, with the last domestic issue completed in December 2016: $90 million 10-year sinking fund debentures, maturing on December 15, 2026, at an "all-in" cost of 2.801%.

The City utilizes a Fiscal Agent to provide expert advice on debenture issues and to lead a syndicate of investment brokers who purchase the City of Vancouver debentures and market them to domestic and international investors. The current syndicate is co-led by RBC Global Markets, CIBC World Markets and National Bank Financial, three of the largest public sector debenture management firms in Canada.

Strategic Analysis

Market Conditions

While global economic activity shows early signs of positive direction, periods of market volatility due to regional events, uncertainty in Europe, Asia, and other areas have kept interest rates low by historical standards. Despite market volatility, investors' appetite for municipal debentures with good credit quality remains strong. Recently, the estimated "all-in" cost for a ten-year issue is in the range of 2.75% to 3.50%, which would continue to be low by historical standards. The City has typically issued ten-year debentures, with the exception of a forty-year debenture issued in 2012 to take advantage of the low rate environment. Staff will continue to monitor the market situation to determine an opportune time to issue, likely in the fall. The Director of Finance recommends that the City be positioned to proceed to market up to an $85 million debenture issue and have the necessary approval in place.

Integral to the City's cash management strategy, any debenture proceeds that are not immediately required to fund capital expenditures will be invested on an interim basis to reduce the debt carrying costs. On the other hand, should market conditions change drastically that preclude such a launch, the capital expenditure program can also be financed internally while awaiting the next opportunity.

Debenture Issuance Process

Given the market volatility and dynamics, the issuer needs to have a high degree of flexibility in determining the timing, structure, interest rate and pricing of the debenture issue right up to the market launch. The schedule of Council meetings at which approval for a debenture issue can be sought does not support such degree of flexibility. It has been Council practice to delegate the authority to initiate a debenture issue to the Director of Finance, in consultation with an advisory group consisting of the Mayor, the Chair of the City Finance and Services Committee, and the City Manager. This group is empowered to make the final decision leading to the issuance of the debentures. Once this group approves the sale, Council is committed to enact the appropriate borrowing by-law as part of the debenture documentation package. This arrangement has worked well in the past and is recommended for the upcoming issue.

Fiscal Agent

As a periodic participant in the capital market, the City relies on its Fiscal Agent to provide expert advice on market conditions; timing, size and structure of the issue; orderly marketing procedures to avoid conflicts with competing issuers; and marketing strategy to achieve the lowest possible borrowing cost for the City. When the City is ready to launch an issue, the Fiscal Agent is responsible for managing the sale of the debentures through a syndicate of investment brokers. The City's current syndicate of 8 financial institutions is led by RBC Capital Markets, CIBC World Markets and National Bank Financial with the Fiscal Agent role alternating amongst the firms.

Borrowing Authorities

The $85 million debenture issue contemplated in this report is comprised of the following borrowing authorities established from the 2015-2018 Capital Plan:

Council approved borrowing authorities	
Waterworks	$ 2,500,000
Sewers & Drainage	$ 40,000,000
Water & Sewer Connections	$ 1,000,000
	$ 43,500,000
Plebiscite approved borrowing authorities, 2015-2018	
Parks	$ 2,000,000
Recreation and Exhibition Facilities	$ 6,000,000
Public Safety Facilities	$ 1,500,000
Streets and Bridge Infrastructure	$ 15,000,000
Street Lighting, Traffic Signals, and Communication Systems	$ 7,500,000
Community Facilities	$ 3,500,000
Civic Facilities and Infrastructure	$ 6,000,000
	$ 41,500,000

The requirement to borrow funds to finance these capital expenditures was established by Council at the time of the approval of the 2015, 2016, and 2017 Capital Budgets.

Debenture Structure

The City has been a regular debenture issuer, with annual issuance in recent years. As reported in the 2016 Annual Financial report, the City had $1,034 million in external debt outstanding as of December 31, 2016. The City has accumulated $418 million in Sinking Fund reserves for retirement of this debt which leaves a net external debt outstanding of $616 million. The summary of outstanding debt and details of the last nine City debenture issues are included in Appendix A.

Implications/Related Issues/Risk (if applicable)

Financial

The annual debt servicing charges (principal and interest) on an $85 million debenture issue are estimated at approximately $10 million subject to bond market conditions upon issuance. Funding will be provided in the annual operating budget where the new debt charges associated with the proposed issuance will be in-part offset by the net savings from the maturity of past issuances and transfers to debt stabilization reserves.

CONCLUSION

The Director of Finance recommends that the City be positioned to proceed to market for up to an $85,000,000 debenture issue and have the necessary approval in place.

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City of Vancouver Debenture Structure

Capital Plan Debenture	Issued ($ 000's)	Maturity	Interest Rate
2007 – 10 year term	125,000	2017-12-01	4.70%
2009 – 10 year term	125,000	2019-12-02	4.90%
2010 – 10 year term	125,000	2020-06-01	4.50%
2011 – 10 year term	140,000	2021-12-02	3.45%
2012 – 40 year term	120,000	2052-10-18	3.70%
2013 – 10 year term	110,000	2023-10-24	3.75%
2014 – 10 year term	105,000	2024-10-16	3.05%
2015 – 10 year term	90,000	2025-11-20	2.90%
2016 – 10 year term	90,000	2026-12-15	2.70%

At December 31, 2016

Total outstanding	1,033,674
Less: Sinking Fund Reserve	417,878
Net outstanding	615,796

Note: $377,528 is the statutory minimum sinking fund reserve
Source: 2016 Annual Financial Report, pages 37 and 38