CITY OF VANCOUVER

**REPORT**

Report Date: June 24, 2021
Contact: Tim Leung
Contact No.: 604.873.7250
RTS No.: 14199
VanRIMS No.: 08-2000-20
Meeting Date: July 20, 2021
Submit comments to Council

TO: Vancouver City Council

FROM: Director of Finance

SUBJECT: Debenture Program 2021 (Inaugural Sustainability Bond)

***RECOMMENDATION***

A. THAT Council authorize the issuance of up to $100 million of City of Vancouver debentures, utilizing borrowing authorities approved as part of the 2019, 2020 and 2021 Capital Budgets as follows:

| Borrowing authorities from the 2019 - 2022 Capital Plan: | | | | |
|---|---|---|---|---|
| Sewers | | | $ | 70,284,220 |
| Street and bridge infrastructure | | | $ | 6,509,850 |
| Street lighting, traffic signals & communications systems | | | $ | 2,370,680 |
| Renovations of community and civic facilities | | | $ | 4,890,000 |
| Maintenance and renovations of parks | | | $ | 1,101,250 |
| Replacement of existing civic facilities | | | $ | 14,844,000 |
| Total 2019-2022 Capital Plan | $ | 100,000,000 | | |

B. THAT, until the borrowing authorities established pursuant to Recommendation A are exercised, the Director of Finance be empowered to act and instruct the City's bank syndicate 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 bank syndicate 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.

C. THAT, pursuant to Recommendation A and B, Council authorize the issuance of City of Vancouver inaugural Sustainability Bonds as part of its regular debenture funding program, as it amplifies the City's commitment to environmental and social sustainability.

## *REPORT SUMMARY*

The purpose of this report is to seek Council's authorization for the Director of Finance to issue up to $100,000,000 of City of Vancouver debentures as part of its regular debenture funding program to finance the City's capital programs. This debenture issuance can take the format of the City's first Sustainability Bond dependent on market conditions and investor demand at the time of issuance and to be decided upon by delegated authority from the Council to the Director of Finance.

The borrowing authorities as outlined in this report were established in the 2019-2022 Capital Plan through Council and electorate approval, and the requirement for debenture funding approved by Council as part of the 2019, 2020 and 2021 Capital Budgets. As the final step in the process, the Director of Finance is seeking authority to exercise these authorities to finance the capital programs.

The City issued its inaugural Green Bond in 2018 under its Green Bond Framework. In June 2020, the City upgraded this framework into a new Sustainability Bond Framework which includes both green and social capital projects. (Link to the new June 2020 Sustainability Bond Framework https://vancouver.ca/files/cov/vancouver-sustainability-bond-framework.pdf).

This new Sustainability Bond Framework represents a further progression in the City's efforts to promote and support environmental and socially responsible goals and objectives. This new framework provides flexibility to issue any one of Green Bonds, Social Bonds, or Sustainability Bonds (combining green and social capital projects). This new framework also aligns with the City's priorities to embed sustainability into financing and investment activities to help contribute positively to society while enabling the transition to a low-carbon, socially responsible, and climate resilient future.

The City's Sustainability Bonds shares the same financial and legal characteristics as other City debentures issued in the past which are backed by the "full faith and credit" of the City of Vancouver. The main difference with the Sustainability Bond is the dedicated use of debenture proceeds. Under the Sustainability Bond Framework, net proceeds from the Sustainability Bonds will be used to finance Council approved capital projects that advance social and/or environmental objectives as determined by the City. Eligible criteria for capital projects are set out in the City's Sustainability Bond Framework.

Funding for the debt servicing charges (principal and interest) arising from the proposed borrowing will be provided in the annual Operating Budgets.

## *COUNCIL AUTHORITY/PREVIOUS DECISIONS*

The City funds capital investments from a range of sources (who pays) using a balanced mix of payment methods (when to pay).

Funding Sources (Who Pays)

- **Property tax and user fees** to fund capital renewal work
- **Development contributions** (Development Cost Levies, Community Amenity Contributions, Density Bonus contributions, etc.) to fund growth-related amenities and infrastructure
- **Partner contributions** from senior levels of government, BC Housing, TransLink, foundations and philanthropists

Payment Methods (When to Pay)

- **Pay in advance** – set aside funds in reserves ahead of future capital investments
- **Pay-as-you-go** – allocate current revenues to fund ongoing capital programs
- **Pay over time** – finance large-scale capital investments that are cost-prohibitive to be funded on a pay-as-you-go basis, and enable taxpayers that benefit from the capital investments to share the costs over time

The City determines its long-term borrowing capacity by limiting the ratio of annual debt servicing to operating revenue at a maximum of 10%. This is to ensure that the City does not accumulate debt at unacceptable levels, and that annual debt servicing does not put undue pressure on the annual budget. As part of the City's long-term debt management strategy, the water utility has transitioned its infrastructure lifecycle replacement program from debt financing to pay-as-you-go. A similar strategy is being undertaken with the Sewer utility. This will help lower the City's overall debt and save interest costs over the long term, and create room in its debt capacity to accelerate the asset renewal program in future years. The City will continue to monitor and adjust its financial strategy to strike a balance between debt financing and pay-as-you-go.

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 programs is established by Council at the time of the approval of the annual capital budget. 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.

In Section 247A of the Vancouver Charter, Council may require that full provision of annual debt servicing charges (principal and interest) be made in the annual operating budget. This debt repayment fund 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 appoint and instruct the City's bank syndicate 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 to investors.

## *CITY MANAGER'S/GENERAL MANAGER'S COMMENTS*

The City Manager recommends approval of the foregoing.

## *REPORT*

### *Background/Context*

The City is the only local 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 of issuances, amounts, 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 with Aaa (stable) by Moody's Investors Service and AAA (stable) by S&P Global Ratings, making City of Vancouver debentures an attractive investment in both domestic and international markets. The City has enjoyed the same level of market access as the MFABC at similar pricing.

Given the City's record of strong financial and liquidity position, the timing for debenture issuance is most often driven by capital market conditions such as global risk appetite, interest rate environments, and investors' demand. The City has been accessing the market annually, with the last issuance in November 2020, which was a $100 million, 1.40% coupon rate, 10-year sinking fund debenture maturing in November 2030, at an "all-in" cost of 1.512%.

The City utilizes a bank syndicate of investment brokers to provide expert advice on debenture issues and to purchase City of Vancouver debentures and market them to domestic and international investors. The bank syndicate comprises of Bank of Montreal, Canadian Imperial Bank of Commerce, National Bank Financial, Royal Bank of Canada, Scotia Capital, TD Bank, Casgrain & Company Limited, and Canaccord Genuity, which collectively provides the widest debenture issuance coverage of investors for Canadian public sector issuers.

### *Strategic Analysis*

#### <u>Market Development</u>

Since 2008, the global demand for green or sustainability bonds has experienced strong growth as investors' appetite for environmentally and socially responsible initiatives is increasingly robust. Global uptake for sustainability-linked debt has doubled since 2018 and stands to surpass $400 billion in 2021.

In the Canadian public sector, Province of Ontario, Province of Quebec, Export Development of Canada, City of Ottawa, and Canada Pension Plan Investment Board have issued Canadian dollar Green Bonds.

**City of Vancouver Sustainability Bond Framework**
(Link https://vancouver.ca/files/cov/vancouver-sustainability-bond-framework.pdf)

The City has developed the Sustainability Bond Framework (the “Framework”) with the intent to issue multiple green, social, or sustainability bonds (combined green and social capital projects) and use the proceeds to finance, in whole or in part, existing and future capital projects that support its environmental and social goals of transitioning to a low-carbon, climate smart and socially inclusive society. The Framework defines eligibility criteria in 11 areas:

1. Renewable Energy
2. Energy Efficiency
3. Green Buildings
4. Clean Transportation
5. Pollution Prevention and Control
6. Sustainable Water and Wastewater Management
7. Environmentally Sustainable Management of Living Natural Resources
8. Climate Change Adaptation
9. Affordable Housing
10. Access to affordable basic infrastructure
11. Access to essential services

This Framework updates and supersedes the City’s 2018 Green Bond Framework with the addition of a new criterion for Climate Change Adaptation (# 8) and three new entries under social categories (# 9, 10 & 11) above.

**Second-Party Opinion by Sustainalytics**
https://vancouver.ca/files/cov/vancouver-sustainalytic-sustainability-bond-framework.pdf

Similar to the second-party opinion for the 2018 Green Bond Framework and in line with industry best practices, the City engaged the consulting firm, Sustainalytics, to review the City of Vancouver Sustainability Bond Framework and provide a second-party opinion.

Sustainalytics completed its review on July 24, 2020 and stated in its opinion that the City of Vancouver Sustainability Bond Framework is credible, impactful and aligns with the ICMA Sustainability Bond Guidelines 2018 including that:

- The Framework’s alignment with the Green Bond Principles 2018, Social Bond Principles 2020, and Sustainability Bond Guidelines 2018, as administered by ICMA.
- The credibility and anticipated positive impacts of the use of proceeds.
- The alignment of the issuer’s sustainability strategy and performance and sustainability risk management in relation to the use of proceeds.
- The Framework’s alignment with the overall sustainability strategy of the municipality and the use of proceeds categories to advance the UN Sustainable Development Goals 6, 7, 10, 11, 12, 13 and 15).

Based on the above, Sustainalytics is confident that City is well-positioned to issue sustainability bonds and that the City of Vancouver Sustainability Bond Framework is robust, transparent, and in alignment with the Sustainability Bond Guidelines, and the four core components of the Green Bond Principles (2018) and Social Bond Principles (2020).

Market Conditions

After the fall-out of COVID-19 lock down and the measures undertaken by the Bank of Canada to cut interest rates to near-zero, global economic activity showed unprecedented levels of intense market volatility. Despite this increased market volatility, investors' appetite for municipal debentures with good credit quality remains strong.

Recently, the estimated "all-in" cost for a 10-year issue is in the range of 2.20% to 2.80%, which would continue to be low by historical standards. The City has typically issued 10-year debentures, with the exception of a 40-year debenture issued in 2012 and the re-opening of this same 40-year debenture in 2019, to take advantage of the low interest rate environment. Treasury Services staff will continue to monitor the market situation to determine an opportune time to issue. Depending on market conditions, the issuance may take place during the fall of 2021 or into the first half of 2022. The Director of Finance recommends that the City be positioned to proceed to market up to a $100 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 programs 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 program can also be financed internally while awaiting the next opportunity.

Debenture Issuance Process

The process of issuing Sustainability Bonds is similar as prior debentures issued by the City. Given the market volatility and dynamics, the City 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. Consistent with past practices, Council shall delegate to the Director of Finance the authority to initiate and execute a debenture issue in accordance with the parameters set out in this report. Prior to executing a debenture issue, the Director of Finance will provide update on terms to the group consisting of the Mayor, the Chair of the City Finance and Services Committee, and the City Manager. Once the Director of Finance executes the sale of debentures into the primary market, Council is committed to enact the appropriate borrowing by-law as part of the debenture documentation package.

Bank syndicate

As a periodic participant in the capital market, the City relies on its bank syndicate to provide expert advice on market conditions; timing of issuances, 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 City's bank syndicate is collectively responsible for managing the sale of the debentures. A senior lead from the bank syndicate will be chosen by the City to lead manage the debenture issuance.

Borrowing Authorities

The $100 million debenture issue contemplated in this report is comprised of the following borrowing authorities established from the 2019-2022 Capital Plan:

| Borrowing authorities from the 2019 -2022 Capital Plan: | | |
|---|---|---|
| Sewers | $ | 70,284,220 |
| Street and bridge infrastructure | $ | 6,509,850 |
| Street lighting, traffic signals & communications systems | $ | 2,370,680 |
| Renovations of community and civic facilities | $ | 4,890,000 |
| Maintenance and renovations of parks | $ | 1,101,250 |
| Replacement of existing civic facilities | $ | 14,844,000 |
| **Total** | **$** | **100,000,000** |

The requirement to borrow funds to finance these capital programs was established by Council at the time of the approval of the 2019, 2020 and 2021 Capital Budgets.

Debenture Structure

The City's inaugural Sustainability Bonds share the same financial and legal characteristics as other City's debentures. The City has been a regular annual debenture issuer in recent years. As reported in the 2020 Annual Financial report, the City had $1,054.6 million in external long-term debt outstanding as of December 31, 2020. The City has accumulated $458.7 million in Sinking Fund reserves for retirement of this debt which leaves a net external debt outstanding of $595.9 million. The summary of outstanding debt is included in Appendix A.

### *Financial Implications*

The annual debt servicing charges (principal and interest) on a $100 million debenture issue are estimated at approximately $13 million, subject to bond market conditions upon issuance. Funding will be provided in the annual operating budgets. On-going debt charges will be offset by anticipated debt maturities and/or use of debt stabilization reserves.

## *CONCLUSION*

The Director of Finance recommends that the City be positioned to proceed to market up to a $100 million Sustainability Bond issue and have the necessary approval in place.

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# APPENDIX A
# City of Vancouver Debenture Structure
# As at December 31, 2020

| **Bylaw** | **Issued ($ 000's)** | **Maturity** | **Interest rate** |
|---|---|---|---|
| 10393 | 140,000 | 2021-12-02 | 3.45% |
| 10565 | 120,000 | 2052-10-18 | 3.70% |
| 10797 | 110,000 | 2023-10-24 | 3.75% |
| 11080 | 105,000 | 2024-10-16 | 3.05% |
| 11362 | 90,000 | 2025-11-20 | 2.90% |
| 11673 | 90,000 | 2026-12-15 | 2.70% |
| 11941 | 85,000 | 2027-11-03 | 2.85% |
| 12203 | 85,000 | 2028-09-21 | 3.10% |
| 12561 (re-opening) | 100,000 | 2052-10-18 | 3.70% |
| 10117 | 2,712 | 2030-09-30 | 1.71% |
| 12307 | 4,000 | 2028-11-20 | 4.07% |
| 12814 | 100,000 | 2030-11-06 | 1.40% |
| **Total debentures** | **1,031,712** | | |
| Unamortized premium[1] | 22,923 | | |
| **Gross debt** | **1,054,635** | | |
| Less: sinking fund reserves | (458,755) | | |
| **Net debt outstanding** | **595,880** | | |

**Notes to table:**
1 – The unamortized premium relates to the accounting treatment for re-opening of the 2052 debentures under Bylaw 12561.