



REPORT

Report Date: June 21, 2022
Contact: Anthony Tia
Contact No.: 604.873.7443
RTS No.: 15109
VanRIMS No.: 08-2000-20
Meeting Date: July 5, 2022
[Submit comments to Council](#)

TO: Vancouver City Council
FROM: Director of Finance
SUBJECT: Debenture Program 2022

RECOMMENDATION

- A. THAT Council authorize the issuance of up to \$120 million of City of Vancouver debenture, utilizing borrowing authorities approved as part of the 2019, 2020, 2021 and 2022 Capital Budgets as follows:

Borrowing authorities from the 2019 - 2022 Capital Plan:

Street and bridge infrastructure	\$	25,000,000
Street lighting, traffic signals and communications systems	\$	25,000,000
Technology projects	\$	7,500,000
Maintenance of community and civic facilities	\$	42,750,000
Renovations of community and civic facilities	\$	5,000,000
Maintenance and renovations of parks	\$	7,500,000
Replacement of existing community facilities	\$	2,500,000
Replacement of existing civic facilities	\$	4,750,000
Total:	\$	<u>120,000,000</u>

- 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 debenture with a coupon rate of 3.7% and a term of 10 years.

It should be noted that once the Director of Finance instructs the bank syndicate to issue the debenture, Council will be required to enact the appropriate borrowing by-law to authorize issuance of the debenture.

REPORT SUMMARY

The purpose of this report is to seek Council's authorization for the Director of Finance to issue up to \$120 million of City of Vancouver debenture as part of its regular debenture funding program to finance the City's capital programs. This debenture issuance can take the format of a conventional debenture, sustainability bond or green bond, 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, 2021 and 2022 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.

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

In October 2012, Council authorized the issuance of a \$120 million City of Vancouver debenture with a term of 40 years to be amortized over a period of 10 years.

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 a debenture issue, Council authorizes the Director of Finance to set the interest rate, price and other terms and conditions on which the debenture 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 debenture is issued.

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 2021, which was the City's inaugural Sustainability Bond, a \$100 million, 2.30% coupon rate, 10-year sinking fund debenture maturing in November 2031, at an "all-in" cost of 2.373%. The City's Sustainability Bond was awarded "Sustainability bond of the year - local authority/municipality" for 2022 by the Environmental Finance magazine (<https://www.environmental-finance.com/content/awards/environmental-finances-bond-awards-2022/>).

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 may comprise singly or any combination 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

In October 2012, Council authorized the issuance of a \$120 million City of Vancouver debenture with 3.7% coupon and a term of 40 years. The key objective for an ultra-long bond was to lock in the historically low interest rate at the time and to maintain a stable borrowing cost for the City's capital program over the 40-year period. Integral to this are the guiding principles adopted by Council as follows:

- Apply the same fiscal discipline as if a 10-year debenture;
- Not defer the debt servicing charges to future generations; and
- Not negatively impact the City's debt profile and credit ratings;

and the implementation structure as follows:

- Amortize the debenture over 10 years (instead of 40 years);
- Accumulate \$120M in the Sinking Fund at the end of Year 10;
- Issue another 10-year debenture in Year 10 at the same coupon rate of 3.7% (instead of prevailing market rate);
- Invest the \$120 million accumulated in the Sinking Fund in the 10-year debenture; and
- Repeat again in Year 20 and 30.

In recent months, central banks around the world have started raising interest rates to cool down global inflationary pressure, and this trend is expected to continue through 2023. Bank of Canada has already hiked its benchmark overnight rate from zero to 150bps this year alone. The market expects another two to three hikes to bring the benchmark overnight rate closer to the neutral zone of 2% to 3% area. Given the current market backdrop, the estimated "all-in" cost for a City of Vancouver 10-year debenture issue is in the range of 4.25% to 5.00%, as compared to the 3.7% coupon rate locked-in through the 2012 40-year debenture. The Director of Finance recommends that the City proceed to issue up to \$120 million of debenture 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

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 issuance of the debenture, Council is committed to enact the appropriate borrowing by-law as part of the debenture documentation package.

Bank syndicate

A senior lead from the bank syndicate will be chosen by the City to lead manage the debenture issuance.

Borrowing Authorities

The \$120 million debenture issue contemplated in this report is comprised of the following borrowing authorities established from the 2019-2022 Capital Plan:

Street and bridge infrastructure	\$	25,000,000
Street lighting, traffic signals and communications systems	\$	25,000,000
Technology projects	\$	7,500,000
Maintenance of community and civic facilities	\$	42,750,000
Renovations of community and civic facilities	\$	5,000,000
Maintenance and renovations of parks	\$	7,500,000
Replacement of existing community facilities	\$	2,500,000
Replacement of existing civic facilities	\$	4,750,000
Total:	\$	<u>120,000,000</u>

The requirement to borrow funds to finance these capital programs was established by Council at the time of the approval of the 2019, 2020, 2021 and 2022 Capital Budgets.

The City has been a regular annual debenture issuer in recent years. As reported in the 2021 Annual Financial report, the City had \$1,013.9 million in external long-term debt outstanding as of December 31, 2021. The City has accumulated \$423.2 million in Sinking Fund reserves for retirement of this debt which leaves a net external debt outstanding of \$590.7 million. The summary of outstanding debt is included in Appendix A.

Financial Implications

The annual debt servicing charges (principal and interest) on a \$120 million debenture issue at 3.7% coupon are estimated at approximately \$15 million, which is \$0.7 to \$1.6 million lower than those based the prevailing interest rates. 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 proceed to issue up to \$120 million of City of Vancouver debenture and have the necessary approval in place. As described above, the Sinking Fund will be investing up to \$120 million in the issued debenture to be held to maturity as part of its regular financial investment portfolio.

* * * * *

APPENDIX A
City of Vancouver Debenture Structure
As at December 31, 2021

Bylaw	Issued (\$ 000's)	Maturity	Interest rate
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%
13149	100,000	2031-11-05	2.30%
Total debentures	991,712		
Unamortized premium ¹	22,202		
Gross debt	1,013,914		
Less: sinking fund reserves	(423,244)		
Net debt outstanding	590,670		

Notes to table:

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