CITY OF **VANCOUVER**

ADMINISTRATIVE REPORT

Report Date:	May 1, 2009
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Meeting Date:	May 7, 2009

TO: Standing Committee on Planning and Environment

FROM: General Manager of Business Planning and Services

SUBJECT: Southeast False Creek Financing Update and Approval of Debenture Program

RECOMMENDATION

A. THAT Council approve borrowing authority of $150 million under authority provided by Section 190.1 of the Vancouver Charter for financing of the Southeast False Creek Area 2A development.

B. THAT Council empower the Director of Finance to act and instruct the City's Fiscal Agent for the Southeast False Creek financing arrangement to proceed with the proposed $150 million debenture issue and to set the rate, price and other terms on which the debenture will be issued by the City.

It should be noted that once the Director of Finance instructs the fiscal agent to offer the debenture in the public markets, Council will be required to pass the appropriate borrowing by-law to authorize issuance of the debenture.

COUNCIL POLICY

Council gets its authority to issue debentures from the Vancouver Charter. Under Sections 236 to 247, Council has the authority to:

i. approve borrowing authority and the issuance of debentures for water, sewer and energy utility purposes without the accent of the electorate;
ii. For all other purposes, Council's authority to approve borrowing authority and to issue debentures arises from approval by the electors of specific borrowing questions normally associated with the City's capital planning process.

Under section 190.1 of the Vancouver Charter approved in January 2009, Council has the authority to approve financing, including borrowing authority and the issuance of debentures for the purposes of financing development of Southeast False Creek Area 2A.

As a pre-condition to an external debenture issue, City Council authorizes the Director of Finance to set the rate, price and other terms and conditions on which the debenture issue will be marketed, 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 to pass the appropriate borrowing by-law after the debentures are sold.

PURPOSE

The purpose of this report is to:

- update Council on the financing arrangements now in place to complete construction of the Olympic Village,
- seek Council's approval of borrowing authority totalling $150 million for this purpose under section 190.1 of the *Vancouver Charter*; and,
- seek authorization for the Director of Finance to issue City of Vancouver debentures to finance under this authority.

BACKGROUND

In 1970, the City opted to maintain a borrowing program outside of the newly created Municipal Finance authority ("MFA"). Council noted a number of issues in making this decision, including the lack of direct representation on the MFA; the loss of control over amounts borrowed and debenture terms and timing by passing responsibility for financing capital program to MFA; the need to contribute to a debt repayment reserve at MFA; and the loss of control over any sinking funds accumulated against City issue debt. Since 1970, the City has continued to borrow in its own name and to manage a significant debenture portfolio, with full control over the process exercised by Council. To facilitate access to the markets, the City maintains long term issuer credit ratings and market access equivalent to MFA.

The City's strong financial position means that the timing for a debenture issue is most often influenced by conditions for market acceptance of an issue and prevailing interest rates rather than by cash flow considerations (i.e. when the funds are required to finance capital expenditures). The City completed its last debenture issue in September 2007 with $125 million in sinking fund debentures sold in the Canadian market. The "all-in" cost of that issue was 4.83%, among the lowest on debt currently issued by the City.

DISCUSSION

1. SEFC Financing Update

In September 2007, the City entered into a series of agreements with the developer of Southeast False Creek (Millennium) and the project lender (Fortress) to facilitate financing arrangements to complete the development of the market project in Area 2A. These arrangements have been previously reported to Council.

In September 2008, Fortress advised Millennium and the City that it would no longer provide financing for the development pending resolution of several default conditions related to the loan, including anticipated costs which exceeded available funding for the project. In order to ensure that construction on the project could continue to meet the Olympic Games completion deadlines agreed to by the City, Council approved a series of "protective advances" to Millennium to finance the project. By March 15, 2009, these advances, including accumulated interest, totalled approximately $175 million.

On January 18, 2009, the provincial legislature passed Bill 47 which provided the City with authority to arrange for and provide financing for the completion of the development in Southeast False Creek Area 2A. This amendment to the *Vancouver Charter* provides access to a range of financial tools to ensure that the City's commitment to complete the village can be achieved and to provide Council increased control over the financial risks associated with the project.

On February 18, 2009, the City purchased and took assignment of the Fortress loan agreement at a cost of approximately $318.0 million. By so doing, the City removed Fortress from the project financing, eliminated certain guarantees made by the City to Fortress and became the primary lender to the project. This purchase and continued protective advances were financed in part with an interim credit facility provided by the Bank of Montreal. At April 15 2009, the City had provided approximately $518 million to the project, including $196 million from the Bank of Montreal facility and $322 million from the City's working capital.

All of these arrangements have been previously reported to Council.

Following purchase of the loan, the City undertook an RFP process to identify a source of up to $700 million in financing to enable the project to be completed to a "market ready" state (expected by August 2010) and then held until the City could recover its financial interest in the project. Six Canadian banks and one offshore financing company responded to the RFP and on the basis of best value, the City entered into agreements with the Toronto Dominion Bank and TD Securities (collectively "TD") for this facility. Based on these agreements, TD sought a syndicate of lenders to assist with the facility.

On April 29, 2009, the City executed a Credit Agreement with a syndicate of Canadian banks, lead by TD, for a $550 million credit facility to be available for up to four years. Participants in the syndication include: TD, Bank of Montreal, Canadian Imperial Bank of Commerce, National Bank Financial, Scotiabank and Royal Bank.

The credit facility – similar to a line of credit - provides flexible terms, competitive market rates reflecting the City's strong credit position and a number of financing tools to complete the financing of the Olympic Village. The City has access to:

- prime rate bank loans;
- Bankers Acceptance contracts which are short term notes (30 – 180 days) endorsed by the financial institution with proceeds made available to the lender (the City); and/or
- a backstop or guarantee for a Commercial Paper program to be established by the City and involving the issuance of short term notes (30 - 180 days) in the City's name.

The credit facility is available on a revolving basis for the duration of the term, meaning the City can draw financing as required and pay down the facility at its discretion and when revenue from the sales of market units is realized. The facility is extendible until April 2013, more than 30 months beyond the "market ready" milestone for the Village.

In addition to the flexible credit facility, up to $150 million of financing is proposed to be raised by the issuance of short to mid-term debentures. Authority for this borrowing is sought in Recommendation A and authority to proceed to market the debenture issue is sought in Recommendation B.

These arrangements will provide significant financial risk mitigation for the City in ensuring completion of the Olympic Village. Based on current interest rates for the financing options available in the arrangement with TD and the other lenders, interest costs to the City for financing the project are likely to be below 4.0% compared to in excess of 9.5% under the Fortress Loan. Based on the original term of the Fortress loan – to January 2011 – and not allowing for any revenues from unit sales, this represents a significant reduction of risk for the City. The resulting interest cost savings will allow the term of the City's loan to the developer to be extended so that the City has an increased opportunity to fully recover the costs of financing and the balance of the purchase price for the land being conveyed to the developer.

At present, the City is advancing funds to Millennium based on the terms in the loan purchased from Fortress and will continue to do so on these terms unless the parties agree to amendments to bring the loan terms more in line with the City's financing arrangements.

2. SEFC Debenture Timing

Working with TD and other investment dealers, staff have been actively monitoring the capital markets over the last few weeks and note that, after several very difficult months, market conditions have improved and that the timing is right for a debenture issue. A more settled tone has returned to the market and over the last few weeks a number of issuers who have been sitting on the sidelines have issued into the market to good reception by investors. These issuers include a number of provincial governments, the Municipal Finance Authority of BC and Region of York, generally indicative issuers in the same bond market into which the City will issue its debenture. Moreover, in addition to historically low rates, investors have been receptive to bond product across the term spectrum from three to 20 years.

As a result of these conditions, it is important that the City be positioned to proceed to market a debenture issue to take advantage of these market conditions, including having the necessary approvals in place.

In marketing a debenture issue, the borrower needs to have complete flexibility to decide on the timing of the sale, the structure of the issue and the interest rate and price of the issue, right up to the point of sale. The timetable of Council meetings at which approval for debenture issues can be sought does not support this degree of flexibility. As a result, the Director of Finance is seeking authority to proceed with the proposed debenture issue in consultation with the City's fiscal agent. Once issued, Council is committed to pass the necessary by-law as part of the debenture documentation package.

In spite of changes in the City's credit rating since January 2009 related to the Southeast False Creek project, the City maintains an excellent credit rating, making City debentures an attractive investment in domestic markets but opening the door to issues in other markets as well. Moody's Investor Services rates Vancouver at AAA (negative) and Standard and Poor's at AA (stable). We will be working with the bond rating agencies over the next weeks to update them on the overall SEFC financing package. The City's ratings are among the best municipal ratings in the country and are close to the ratings of many Canadian regional municipalities and the Municipal Finance Authority and make City of Vancouver debentures very attractive to investors. On the basis of a 36 to 48 month issue, it is anticipated the nominal yield on this issue will be approximately 3.0%.

3. Other City Borrowing

In addition to the proposed $150 million debenture, the City has normal capital expenditure borrowing for which placement in 2009 would be preferable. Authorities for a debenture issue of up to $125 million are currently in place. The Director of Finance has been waiting for a resolution to the Olympic Village financing issues and an opening in the market to issue this debt. As the term of this issue is likely to be longer than the SEFC debenture – 10 years versus 3 - 4 years – it should not compete with the SEFC debentures. In fact, with the right market conditions, there may be an opportunity to issue them concurrently.

4. Fiscal Agent

As a periodic participant in the capital markets, it is impossible for the City to be up to date on the borrowing conditions or to have access to the extensive infrastructure necessary to market a debenture issue. The City therefore relies on a "fiscal agent" to assist with our borrowing program. The "fiscal agent" provides expert advice on a variety of issues related to issuance of debentures, including market conditions, the timing, size and structure of debenture issues; orderly marketing procedures to avoid conflicts with similar competing borrowers; and favourable marketing of the name of the borrower to the capital markets. This service is particularly critical when the City is preparing to launch a debenture issue because significant savings in interest costs are possible if a borrower can position itself to take advantage of favourable market conditions. When the City is ready to launch an issue, the fiscal agent is responsible for managing the sale of the issue through a syndicate of brokers.

Under the Credit Agreement signed with TD, the members of the credit facility syndicate will also participate in the debenture syndicate with TD acting as the "fiscal agent" and each member being responsible for taking a representative share to the market. The issue will be done on an "underwritten" basis, meaning that the syndicate will guarantee the sale of the debentures.

FINANCIAL IMPLICATIONS There will be no financial implications for the City's operating budget as a result of the recommended debenture issue. Interest costs will be accrued within the credit facility and will be payable at maturity along with the principal. On the assumption that the City realizes the full value from the Millennium Water project, the debenture can be retired without impact on the Operating or Capital Budgets.

CONCLUSION

The Director of Finance is seeking authority to take advantage of anticipated market conditions by having authorities in place to issue a City of Vancouver debenture in the next few weeks.

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