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DATE: May 15, 2010

REPORT TITLE: **AUTHORIZATION FOR DEBENTURE ISSUE(S)**

FROM: Norma Trim, Chief Financial Officer and Commissioner of Corporate Services

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**RECOMMENDATION**

**That the Chief Financial Officer and Commissioner of Corporate Services (“CFO”) be authorized to negotiate one or more debenture issues in 2010 in a total principal amount not to exceed \$400 million, and to report on the terms and the submission of the necessary by-law(s);**

**And further, that the debenture issues in 2010 include the issuance of debentures in the maximum principal amount of \$5,381,277 on behalf of the Town of Caledon;**

**And further that the Lead/Co-Lead Managers of the Region of Peel’s Canadian Debt Issuance Syndicate for 2010 be the CIBC World Markets Inc., RBC Capital Markets Inc., and National Bank Financial Inc.;**

**And further, that the Banking Group of the Region of Peel’s Canadian Debt Issuance Syndicate for 2010 be BMO Financial Group, Scotia Capital inc. and TD Bank Financial Group;**

**And further, that the Treasurer and CFO be authorized to negotiate and sign the Syndicate Agreement, including the percentage allocated to each of the different groups and participants, and an additional percentage for the Lead Manager;**

**And further, that a By-Law be approved authorizing the issue of replacement debenture certificates and requiring an indemnity or bond of indemnity, lost document bond or similar instrument as a condition of issuing such replacement debenture certificates;**

**And further, that a By-Law be approved authorizing the Regional Chair and the Treasurer to sign a modified version of the standard form of the Book Entry Only Securities-Services Agreement and any associated documents with CDS Clearing and Depository Securities Inc. (“CDS”) for the provision of clearing and depository services for the Region’s debenture issues.**

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**AUTHORIZATION FOR DEBENTURE ISSUE(S)****REPORT HIGHLIGHTS**

- Long-term debt funding of the growth related capital plan was anticipated through the 2007 Development Charges ("DC") By-law review and associated financing costs were built into the DC rates established at that time.
- In a report dated November 18, 2009 titled "2009 Annual Update on Status of the Development Charge Reserve Funds" the CFO reported a net deficit position in DC reserve funds of \$149.6 million and that external borrowing would be required. This deficit has grown to \$262 million as at April 30, 2010.
- While this deficit has been temporarily funded by borrowing from non-DC reserves, both the magnitude of the borrowing requirements and favorable borrowing rates make this the appropriate time to replace the temporary financing with long-term financing through the issue of debentures.
- In April the CFO was given approval to finance the purchase of a new building in Mississauga for front-line service delivery through the issue of debentures and Caledon Council has recently approved a debenture issuance to finance the Bolton Arterial Route on Coleraine Drive project.
- Smart use of long-term debt is necessary to protect the Region's strong liquidity position and AAA credit rating going forward.
- Current conditions in the capital market are at historically low interest rates for long-term debt issued by secure, stable governments.
- July and August are not preferred months to issue debentures and with the interruption to the Council schedule this fall, the Region may not be able to issue later this year and staff is therefore recommending that we issue the debentures now.

**DISCUSSION****1. Background**

The Region uses a multi-faceted plan or approach to ensure the sustainability of its capital program. To finance growth in the Region, the 2007 Development Charges Update exercise recognized that it would be necessary to incur long-term debt for a period of time to pay largely for the major water and wastewater treatment plant expansions which must be put in place in order to service future growth.

The expectation that borrowing would be required to fund annual DC shortfalls has been discussed with Regional Council through regular updates since the adoption of the DC by-law 115-2007 and as part of the 2009 and 2010 capital plan management processes.

*DC Background Study (2007)*

A net deficit position in the DC reserve funds was anticipated and included in the DC Background Study starting in 2007. This was particularly evident in the initial years given the major utility expansion projects included in the DC Background Study. The financial modeling used to generate the DC rates assumed debt financing and anticipated a \$0 balance by the end of 2031, which is the planning horizon of the DC program. It should be noted that the actual annual deficits in DC funding for 2007 through 2009 have been smaller than those forecast in the DC Background Study because of delays in the timing of the capital spending.

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*Update of DC Reserve Funds (2008 and 2009)*

Staff has provided annual updates on the status of the DC reserve funds since approval of the DC by-law. Council was advised of the deficit status of the DC reserve funds and the need to undertake external borrowing through the report from the CFO titled "2009 Annual Update on Status of the Development Charges Reserve Funds" dated November 18, 2009. At that time the deficit was \$149.6 million and has grown to \$262 million as at April 30, 2010. While this deficit has been temporarily funded by borrowing from non-DC reserves, both the magnitude of the borrowing requirements and favorable external borrowing rates make this the appropriate time to replace the temporary financing with long-term financing through the issue of debentures.

*2009 and 2010 Capital Plan Management*

As was communicated to Regional Council at the time of both its 2009 and 2010 Capital Plan review, the sustainability of the Regional capital program requires a multi-faceted approach. As part of the 2010 presentation Council was reminded of the comprehensive strategy to managing the Capital Plan. (see Figure 1).

**Capital Plan Management**

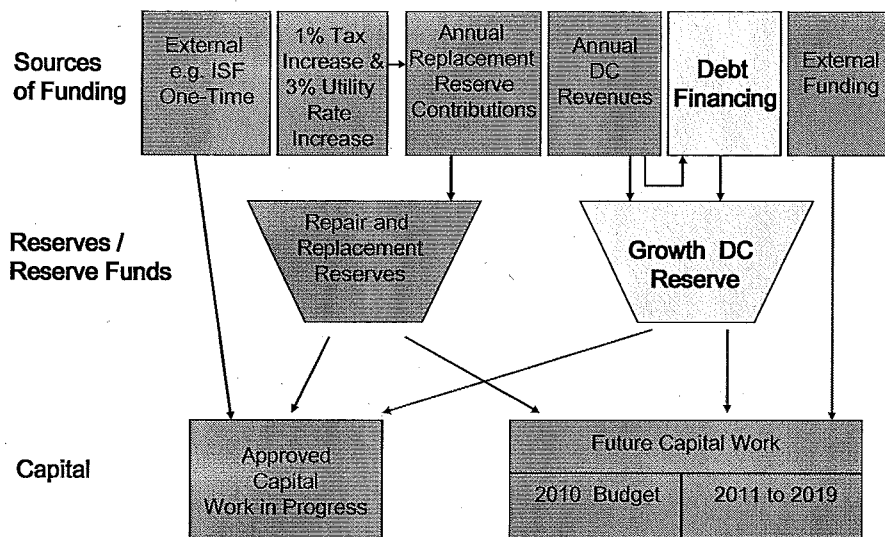


Figure 1

As previously noted, it will be necessary to incur long-term debt for a period of time to pay mostly for the major water and wastewater expansions which must be in place to accommodate growth. This multi-year borrowing primarily for the major water and wastewater expansions will end and the debt will be paid down in subsequent years as DC expenditures moderate and DC revenues grow.

For repair and replacement (non-growth), Council was advised of the need to continue with actions that were already underway, consisting of:

- For tax funded repair and replacement: it was proposed as part of the 2008 Budget, that reserve contributions increase by an amount equivalent to a 1 per cent tax increase in each of the next 10 years, which would allow the Region to avoid incurring long-term debt for the repair and replacement of tax supported capital projects.

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- For rate funded repair and replacement reserves: an indefinite top up of annual reserve contributions was introduced in 2009, equivalent to a 3 per cent annual utility rate increase to fund future repair and replacement.
- Staff also advised of the need to advance the work on the Corporate Asset Management initiative which will start to better inform our decisions around appropriate reserve contributions to maintain state of good repair.

Although annual increases to the level of reserve contributions were suspended in the 2010 Budget in light of the difficult economic environment, resumption of the annual increases are expected to occur in the 2011 Budget.

It is this comprehensive approach to capital sustainability and reserve management which has allowed the Region to consistently achieve an AAA credit rating. In April 2010, Standard & Poor's (S&P) reconfirmed the Region's AAA status. S&P has maintained a stable outlook for the Region reflecting the expectation that Peel's economy will not encounter a prolonged slump and that Peel will continue to maintain strong cash and liquid investment balances. Not meeting these expectations could lower the Region's rating in the future which would impact the cost of long-term financing going forward.

In April the CFO was given approval to finance the purchase of a new building in Mississauga for front-line service delivery through the issue of debentures.

## 2. Proposed Direction

### *Maintaining Credit Rating*

To support the Region's high AAA rating, it is necessary to maintain cash and investments at a level that provides a significant cushion on operating flows. At the time of writing this report, liquid investments total \$1.0 billion. Liquid investments are important for the Region's cash flow, allowing it to effectively deal with unexpected expenses like H1N1, take advantage of opportunities like infrastructure stimulus funding and phase-in the effect of unanticipated events such as the recent economic downturn. It is unclear what level of liquidity S&P considers adequate to maintain our credit rating. However, if we do not issue debentures this year, we can expect a further draw-down against cash and liquid investments of at least \$300 million.

Maintaining a high credit rating is an objective that the Region of Peel considers strategically important as this rating provides a third party validation as to the strength of its financial position and the quality of the Region's management. A high rating confirms that the public and other businesses can have high trust and confidence in the Region. The immediate financial benefit allows the Region to borrow at the lowest possible cost available when issuing debentures.

In addition to utilizing reserves other options to manage long-term debt such as deferring capital spending and increasing property tax commitments were also reviewed, but are not considered as effective alternatives to issuing debentures.

### *Smart Use of Debt*

The smart use of long-term debt is an effective management tool historically utilized by competitive and profitable businesses. Businesses often utilize long-term debt to leverage return on investments in order to benefit shareholders. Through periods of growth, businesses will utilize long-term debt to fund the acquisition of major capital assets so as not to impinge upon working capital, which could hamper day-to-day operations.

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Municipalities incur long-term debt to finance the significant infrastructure which must be put in place in order to accommodate growth in the community. Pay-as-you-go strategies may work in circumstances where the return on investment is rather short, typically under ten years. However, for major capital projects, such as those being undertaken by the Region for its water and wastewater programs, debt tied more closely to asset life is a much more prevalent business practice. All of the Region's current consolidated long-term debt represents Peel Housing Corporation mortgages for social housing.

Staff recommend that debentures be issued at the Regional level primarily to provide appropriate levels of cash flow for the large utility expansions required to accommodate growth until the long-term debt can be repaid with DC revenues collected over the lives of the assets.

Council has already approved the issuance of debentures be used for the purchase of the new front line service delivery building in Mississauga.

Attached as Appendix I is approval from the Town of Caledon to issue debentures up to the maximum principal amount of \$5,381,277 for a period not to exceed 30 years in order to finance the Bolton Arterial Road on Coleraine Drive project. This level of long-term debt is well within the Annual Debt Repayment Limit of the Town of Caledon. As required under the *Municipal Act 2001*, debentures must be issued by the Regional level of government, not by the Region's lower-tier municipalities.

It is recommended to authorize the Region of Peel to issue debentures of up to the maximum principal amount of \$400 million for the above noted purposes at this time. This is a very modest amount of long-term debt given that the current value of our non-financial assets is over \$14 billion. This level of long-term debt is well within the Region's Annual Debt Repayment Limit.

Since the beginning of the 2010 calendar year, over \$8 billion of long bonds (greater than twenty years) have been issued by provincial and municipal governments in Canada and new and/or existing issues continue to be brought to the market.

At a recent Government Finance Conference hosted by the Bank of Montreal, the Ontario Financing Authority stated that "the efficient frontier of debt issuance in Canada is firmly in the 30 year range and if it were possible, the Province of Ontario would be issuing all of their debt requirements at that term".

### *Benefits of Issuing Long term Debt*

The benefits of issuing debentures for a 30 year term include the following:

- the markets for the longer term are quite favorable compared to a shorter 10 or 20 year term;
- interest rates are at near historically low rates, a very favorable scenario to lock in rates at these levels;
- longer term debentures enhance the overall liquidity and marketability of Regional debentures, thereby attracting a larger potential pool of investors;
- with longer term debentures, annual debt charges would be significantly lowered during the life of these debentures, and
- allows us to pay back the debentures with DC revenues received over the useful asset lives of the utility expansions in respect of which long-term debt is being incurred.

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### *Financial Risks Associated with Delaying Debt Issuance*

Both 10 year and 30 year interest rates, while having risen somewhat this year, still remain at very low levels. Both 10 and 30 year interest rates are expected to rise in the coming months. If interest rates were to rise by 10 basis points (0.10%) based upon a \$100 million debenture issuance, the added interest costs would amount to \$1 million on a 10 year debenture issue and \$3 million on a 30 year debenture issue.

Staff research indicates that July and August are normally not the best months to issue debentures and given the interruption to the Council schedule this fall, it is recommended that the Region issue debentures before the end of June. In order to accommodate this timeframe, it will be necessary following the sale of the debentures for Council to approve the necessary debenture by-law(s) at its June 24<sup>th</sup> Regional Council meeting.

In order to allow for the opportunity for Peel residents to invest in Peel's debenture issue, staff is recommending that the CFO be given the flexibility to negotiate more than one debenture term in respect of any one debenture issue since the 30 year term may not appeal to residents of Peel.

### 3. Administrative Procedures

#### *Appointment of a 2010 Canadian Debt Issuance Syndicate*

As some members of Council may recall, from time to time staff review the makeup of the Region's Canadian Debt Issuance Syndicate to take into account active member firms participating in the municipal bond market and to recommend adjustments to the syndicate if and as necessary.

While there is no standard syndicate that is being utilized by municipalities in Ontario, the typical membership of a syndicate consists of at least two Managers and two or more members of a Banking Group. Review has shown that each Manager is apportioned a major share of the syndicate, while the Banking Group is apportioned lesser shares.

The recommended structure of the Region's Debt Issuance Syndicate is as follows:

#### Lead/Co-Lead Managers:

CIBC World Markets Inc.  
RBC Capital Markets Inc.  
National Bank Financial Inc.

#### Banking Group:

BMO Financial Group  
Scotia Capital Inc.  
TD Bank Financial Group

The three Lead/Co-Lead Managers constitute the financial institutions that are most active and have the greatest experience in the issuance of municipal debentures. The three members of the Banking Group while not as active as the managers, nevertheless have developed a strong presence in the Canadian municipal bond market.

#### *Clearing and Depository Services for Regional Debenture Issues*

As noted in the companion report from the CFO dated May 15<sup>th</sup>, titled "Options for Issuing Debentures", CDS is the only agency that provides a clearing and depository service for issuers of Canadian debt. Effective August 2009, CDS required Ontario municipalities that wish to deposit debentures in the CDS system to enter into a new Book Entry Only

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Securities-Services Agreement ("BEO SSA"). A coalition of Ontario municipalities negotiated with CDS to modify certain terms of the BEO SSA to ensure that its provisions are more favourable and appropriate for Ontario municipalities. A By-law authorizing the Regional Chair and the Regional Treasurer to enter into the modified BEO SSA is required.

Prior to approving the above By-law, it is deemed appropriate to approve a By-law to authorize the issue of replacement debenture certificates and requiring an indemnity or bond of indemnity, lost document bond or similar instrument as a condition of issuing such replacement debenture certificates.

**CONCLUSION**

Council has been made aware of the pending need to borrow to offset anticipated cash flow shortfalls in DCs. The issuance of external debt is an effective means by which the Region can fund its borrowing requirements. In order to protect Peel's credit rating and take advantage of historically low interest rates, the timing is now appropriate for Council to authorize the Region of Peel to issue debentures.



Norma Trim  
Chief Financial Officer  
and Commissioner of Corporate Services

**Approved for Submission:**



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D. Szwarc, Chief Administrative Officer

*For further information regarding this report, please contact Dave Bingham at extension 4292 or via email at [binghamd@peelregion.ca](mailto:binghamd@peelregion.ca)*

c. Legislative Services

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**APPENDIX I**

**THE CORPORATION OF THE TOWN OF CALEDON**

**BY-LAW NO. 2010-049**

Being a by-law to authorize the construction of Phase 3 of Bolton Arterial Route on Coleraine Drive and to apply to the Regional Municipality of Peel for the issuance of debentures for such construction

**WHEREAS** Council has considers it to be in the public interest to authorize the construction of Phase 3 of the Bolton Arterial Route on Coleraine Drive and to apply to the Region Municipality of Peel for the issuance of debentures for such construction


**AND WHEREAS** Council, by By-law 2009-170, adopted the 2010 Budget for the Town of Caledon containing therein the construction of Phase 3 of the Bolton Arterial Route on Coleraine Drive and direction to apply to the Region Municipality of Peel for the issuance of debentures for such construction

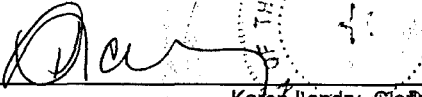
**AND WHEREAS** the Treasurer has certified that the amount of debentures referred to herein are within the Town of Caledon's updated annual financial debt and obligation limit

**NOW THEREFORE COUNCIL FOR THE CORPORATION OF THE TOWN OF CALEDON** enacts as follows.

1. THAT the construction of the Bolton Arterial Route on Coleraine Drive, Phase 3, from Holland Drive to King Street, at an estimated cost of \$12,343,382 is hereby authorized.
2. THAT for the purpose of paying part of the estimated cost in the amount of \$5,381,277 an application to the Regional Municipality of Peel for the issuance of debentures in the maximum amount of \$5,381,277 for a term not to exceed 30 years is hereby authorized.
3. THAT the sums of principal and interest payable to the Regional Municipality of Peel under the debentures will be raised in each year through the assessment on all rateable property within the Town of Caledon and through the payment of development charges.
4. THAT the Clerk and the Treasurer are authorized to execute any and all documents for the purpose of the issuance of such debentures by the Regional Municipality of Peel.
5. THAT this by-law comes into force and effect when finally passed.

**READ THREE TIMES AND FINALLY  
PASSED IN OPEN COUNCIL  
this 6th day of April, 2010.**

  
Marilyn Morrison, Mayor

  
Karen Landry, Clerk

