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Region of Peel
Working for you

REPORT
Regional Council

DATE: February 11, 2011

REPORT TITLE: **2011 TEMPORARY AND DEBENTURE BORROWING**

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

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RECOMMENDATION

That the necessary by-law be presented authorizing the temporary borrowing of monies to meet 2011 expenses of the municipality pending receipt of revenues in accordance with section 407 of the *Municipal Act, 2001* (amended in 2009);

And further, that the Chief Financial Officer and Commissioner of Corporate Services ("CFO") be authorized to negotiate a debenture issue(s) in a total principal amount not to exceed $500 million in 2011 and not to exceed a term of 30 years;

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

And further, that the Banking Group of the Region of Peel's Canadian Debt Issuance Syndicate for the term of Council be Scotia Capital Inc. and TD Bank Financial Group;

And further, that the Treasurer and the 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 necessary by-law be presented authorizing the formation of a Committee known as the "Debt Issuance Committee", which is to be formed in accordance with the Terms of Reference contained within Appendix I of the report of the Chief Financial Officer and Commissioner of Corporate Services, dated February 11, 2011, titled "2011 Temporary and Debenture Borrowing", and to delegate authority to the Debt Issuance Committee to make final decisions with respect to the issuance of debentures where the project debt authority has been approved by Council with one or more debt issues and to finalize the terms and conditions of such debt issues.

REPORT HIGHLIGHTS

- Authorization of temporary borrowing to meet expenses pending receipt of revenues is a prudent and traditional cash flow management measure and such authorization requires the passage of an annual by-law to comply with legislation. Budget estimates, excluding contributions from reserves and any prior years' surplus, are utilized to derive the maximum amount of temporary borrowing permitted under the *Municipal Act*. Until the budget is adopted in a year, the limits upon temporary borrowing are calculated using the estimated revenues as set out for the previous year.
- 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 December 24, 2010, the CFO reported the Status of Reserves and that external borrowing would be required to fund the DC deficit. As at February 5, 2011, the DC Reserve balance as at December 31st was at a deficit of $229.0 million (net of 2010 borrowing).
- While the DC reserve deficit has been temporarily funded by borrowing from non-DC reserves, both the overall magnitude of the borrowing requirement and the favourable long-term borrowing rate environment makes this the opportune time to replace such temporary financing with long-term financing through the issuance of debentures in the capital markets.
- Smart use of long-term debt is necessary to protect the Region's strong liquidity position and to maintain its AAA credit rating going forward.
- Two debenture issues are planned to raise the total principal requested. Mid-February through to mid-March (pre-March break) presents a good opportunity for the first issue.
- Following Council's approval of issuance of debt and term limits of debt for the year, debenture issues had to be timed to the Council meeting schedule, where the by-law would be directly tabled due to tight timelines in the capital markets.
- To provide greater flexibility to meet these tight timelines and to reduce Council's administrative burden at the closings of a debenture issue, a by-law has been prepared to authorize the establishment of a Debt Issuance Committee in accordance with the terms of reference document described in Appendix I. It is proposed that this Committee be comprised of the Regional Chair, Chair of the Management Committee, the Chief Administrative Officer and the Chief Financial Officer.

DISCUSSION

1. Background

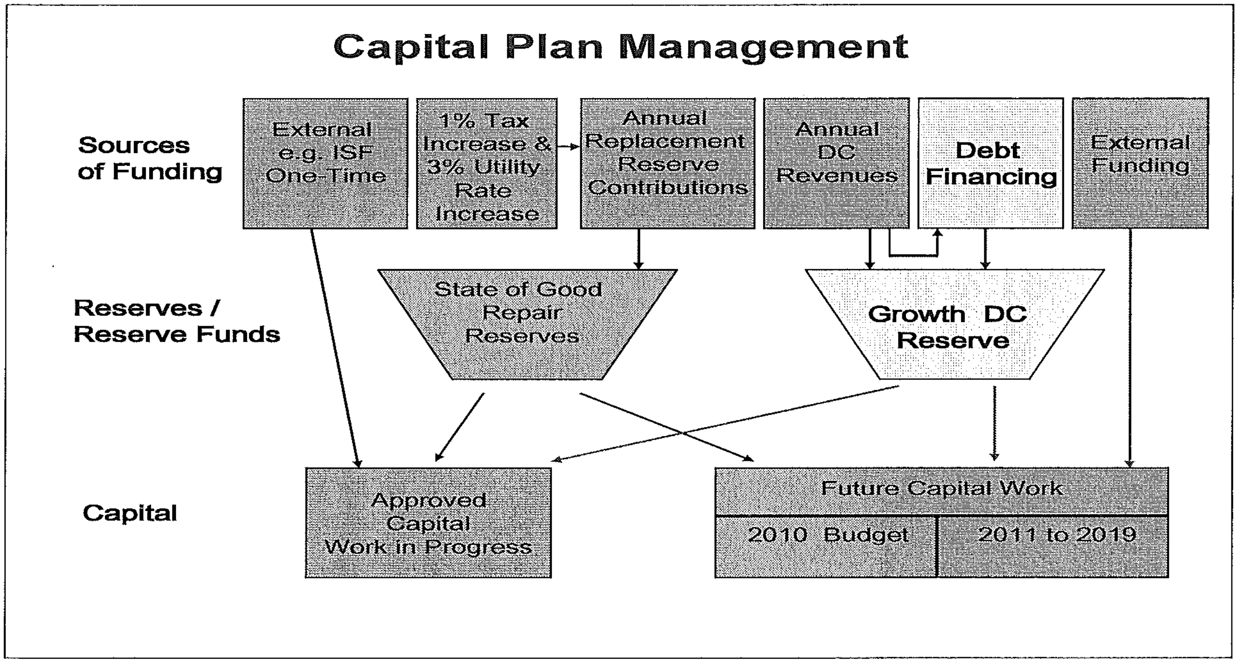
Temporary Borrowing
To comply with section 407 of *The Municipal Act, 2001,* it is necessary to pass an annual by-law that allows the Region to periodically borrow funds to meet the expenses of the municipality, until such time that taxes and other revenues are received. This report provides the necessary administrative authority to the Corporate Services Department to continue to operate in an efficient and effective cash management program, primarily through the utilization of line of credit bank funding should the Region encounter an overnight cash shortfall.

Long-Term Borrowing
In a report dated May 15, 2010, the CFO reported on the Region's need to begin issuing debentures and sought authorization to issue debentures up to a maximum principal amount of $400 million. On June 24, 2010 Regional Council approved By-law 50-2010 and By-law 51-2010 to authorize borrowings totaling $310 million of which $254.6 million was DC related. On January 13, 2011, Council received and approved a report on the Issuance of Debentures totaling $67.3 million through the Canada and Mortgage Housing Corporation, all of which was in relation to Development Charges.

On the growth side, the 2007 Development Charges By-law Update recognized that it would be necessary to assume debt for a period of time primarily to pay for the large water and wastewater system expansions which must be put in place in order to accommodate future growth until development charges are collected at the time of building permits issuance. The expectation that borrowing would be required to fund annual shortfalls in development charges 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, 2010 and 2011 capital plan management processes.

Update of DC Reserve Funds (2008, 2009 and 2010)
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 "Overview and Update on Status of Reserves" dated December 24, 2010. As at February 5, 2011, the DC Reserve balance as at December 31st was at a deficit of $229 million after applying the 2010 debenture proceeds. While this deficit has been temporarily funded from internal borrowings, both the magnitude of the borrowing requirements and favorable borrowing rates make this the appropriate time to issue additional debt.

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 below).



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

Maintaining Credit Rating
It is this comprehensive approach to capital sustainability and reserve management which has allowed the Region to consistently achieve an AAA credit rating. In our most recent review, 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 trigger a reconsideration of the Region's credit rating possibly resulting in a lower rating in the future, which would impact the cost of debt going forward. At the time of writing this report, liquid investments totalled $1.1 billion. Liquid investments are important to pay for (cash flow) unexpected expenses like H1N1, to take advantage of opportunities like infrastructure stimulus funding and phase-in shocks such as the impacts of economic downturns. To further strengthen the Region's ability to issue long-term debentures to the capital markets, the Region has recently engaged Moody's Investor Services to provide a second credit rating service. While it is unclear what level of liquidity Moody's and S&P consider adequate to maintain our credit rating, if we do not issue debt this year, we can expect a further draw-down against cash and liquid investments of an estimated $200 - 300 million, in addition to the DC Reserve deficit of $226 million.

2. Proposed Direction

Temporary Borrowing
Budget estimates of revenue requirements for 2010, excluding contributions from reserves and any prior year surpluses, may be used to derive the maximum amount of temporary borrowing permitted by the Act. The estimated revenue for 2010 as at October 31st is $1,509,216,670; therefore the maximum amount that may be borrowed at any one time on a temporary basis from January 1st to September 30th 2011 is $754,608,335 and $377,304,167 from October 1st to December 31st 2011. It is forecasted that the above

mentioned limits will represent an amount sufficient to meet the temporary borrowing requirements for the 2011 current expenditures.

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

Municipalities incur 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 10 years. However, for major capital projects, such as being undertaken by the Region for its water and wastewater projects, debt tied to asset life is a much more prevalent business practice.

Staff recommends that debentures be issued primarily to provide appropriate levels of cash flow to fund the large utility expansions required to accommodate growth in Peel until the long-term debt can be repaid with DC revenues collected over the lives of the assets.

It is recommended to authorize the Region of Peel to issue debentures of up to the maximum of $500 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 $17 billion. This level of debt is well within the Region's revised Annual Debt Repayment Limit.

In the 2010 calendar year, provincial and municipal governments in Canada issued over $14 billion in long bonds (greater than 20 years) and new and/or existing issues continue to be brought to the market.

Benefits of Issuing Long term Debt
The likely benefits of retaining the flexibility to issue bonds for up to a 30 year term include the following:

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

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 debt 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 when greater than $400 million is being issued in one year, it is often beneficial to issue these in two benchmark sized issues of at least $200 million each to gain greater market acceptance. Two debt issuances in a year also allows for a better matching of our cashflow needs. Such timing of debt issuance will also minimize the amount of borrowing taken on in any one day and may reduce overall interest costs.

Issuing the first debt in the mid-February through to mid-March (pre-March break) period is advantageous as there is little in the way of long-term Provincial debentures likely to be issued during this period due to a blackout period leading up to budgetary releases due from Ontario in March.

3. Administrative Procedures

Appointment of a Term of Council 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. External Legal Counsel recommends that the appointment of a Canadian Debt Issuance Syndicate be re-affirmed by each incoming Council.

While there is no standard Syndicate that is being utilized by municipalities in Ontario, the typical membership consists of at least two managers and two or more members of a Banking Group. Review of existing Syndicates 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 Canadian Debt Issuance Syndicate is as follows:

Lead/Co-Lead Managers:
- CIBC World Markets Inc.
- RBC Capital Markets Inc.
- National Bank Financial Inc.
- BMO Financial Group

Banking Group:
- Scotia Capital Inc.
- TD Bank Financial Group

Debt Issuance Committee
Annually, Council approves the issuance of debt and the term limits of this debt. The CFO uses this authority to work with the Region's Canadian Debt Issuance Syndicate to place an issue in the capital markets at an opportune time. This debt issue is then formally closed by Council with the passing of a debenture By-law(s), usually on a regularly scheduled Regional Council date.

To lessen this administrative burden upon Council, including those periods when Council is not available, such as during an election period, summer holiday months or statutory holidays, a number of Ontario municipalities (including Toronto, Ottawa and the Region of York) have delegated the authority to enact borrowing By-laws to a Debt Issuance Committee. A Debt Issuance Committee provides greater flexibility to settle debt issues within days rather than weeks and the Region's Canadian Debt Issuance Syndicate would have the ability to respond more quickly to favourable interest rate conditions. Although there are no certain financial implications, other municipalities have estimated that the flexibility and efficiency offered through the establishment of the Debt Issuance Committee could save up to $30,000 per year per $100 million of debt issued due to shorter settlement of proceeds time frames.

CONCLUSION

In order to comply with provincial legislation, it is proposed to pass the appropriate temporary borrowing by-law. The recommended by-law will facilitate any unanticipated cash flow shortfalls that we may experience and any inter-fund borrowing requirements.

Council has been made aware of the pending need to borrow funds 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 preserve 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.

With the establishment of the proposed Debt Issuance Committee, the Region's long-term borrowing program would be more efficient and flexible, thereby providing significantly more opportunities to access the capital markets on a timely and cost-effective basis.

Norma Trim
Chief Financial Officer
and Commissioner of Corporate Services

Approved for Submission:

D. Szwarc, Chief Administrative Officer

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c. Legislative Services

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APPENDIX 1

Terms of Reference
Debt Issuance Committee

MEMBERS OF THE DEBT ISSUANCE COMMITTEE

- The Debt Issuance Committee shall consist of the following members:
    - The Regional Chair (or their designate, who is to be a member of Council). The Regional Chair (or their designate) shall be the Chair of the Debt Issuance Committee.
    - The Chair of the Management Committee (or their designate, who is a member of Council)
    - The Chief Administrative Officer (or their designate)
    - The Chief Financial Officer (or their designate)

QUORUM

- A quorum shall be two members of the Committee, with at least one of the two members being the Regional Chair or the Chair of Management Committee.

TERM

- The delegation to the Debt Issuance Committee shall not be revoked before the end of the term of Regional Council at which time this delegation may be revoked otherwise this delegation remains in effect;
- The Debt Issuance Committee membership service is irrevocable and members serve by virtue of their positions until a successor is appointed.

RESPONSIBILITIES

- The Debt Issuance Committee is delegated the authority to make the final decisions with respect to the following matters to the extent that the authority has not already been delegated:
    1) The authority to enact debenture by-laws to authorize the issuance of debentures where the project debt authority has already been approved by Council.
    2) The authority to enact temporary borrowing by-laws for current operations in accordance with section *407 of the Municipal Act, 2001* to authorize short term borrowings for the purpose of meeting current expenditures in any year until such time as the taxes are collected and other revenues are received.
    3) The entering into of bank loan agreements.

4) The entering into of financing and other agreements in connection with long-term borrowings offered through governments and their agencies.

REPORTING

- The Debt Issuance Committee shall provide minutes of Committee meetings to Council regarding the exercise of its delegated authority at the earliest opportunity after each debenture issuance and after the entering into of each long-term borrowing agreement.

PROCEDURES

- The Debt Issuance Committee shall meet at the call of the Committee Chair.
- Except as noted within the by-law, to effectively execute their responsibilities, the Debt Issuance Committee shall be subject to the provisions of the Procedure By-law and meeting notices will be given to members of the Debt Issuance Committee and posted to the Region's website a minimum of 2 calendar days in advance of the meeting.
- A designate of the Regional Clerk will provide secretariat support to the Debt Issuance Committee.