MA-B2-1

Region of Peel
Working for you

REPORT
Meeting Date: May 24, 2012
Regional Council

DATE: April 30, 2012

REPORT TITLE: **2012 DEBENTURE BORROWING APPROVAL**

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 a debenture issue(s) in a total principal amount not to exceed $400 million in 2012 and not to exceed a term of 30 years;

And further, that the debenture issues in 2012 include the issuance of debentures in the maximum principal amount of $21.0 million on behalf of the City of Mississauga and a further $3.0 million on behalf of the Town of Caledon.

REPORT HIGHLIGHTS

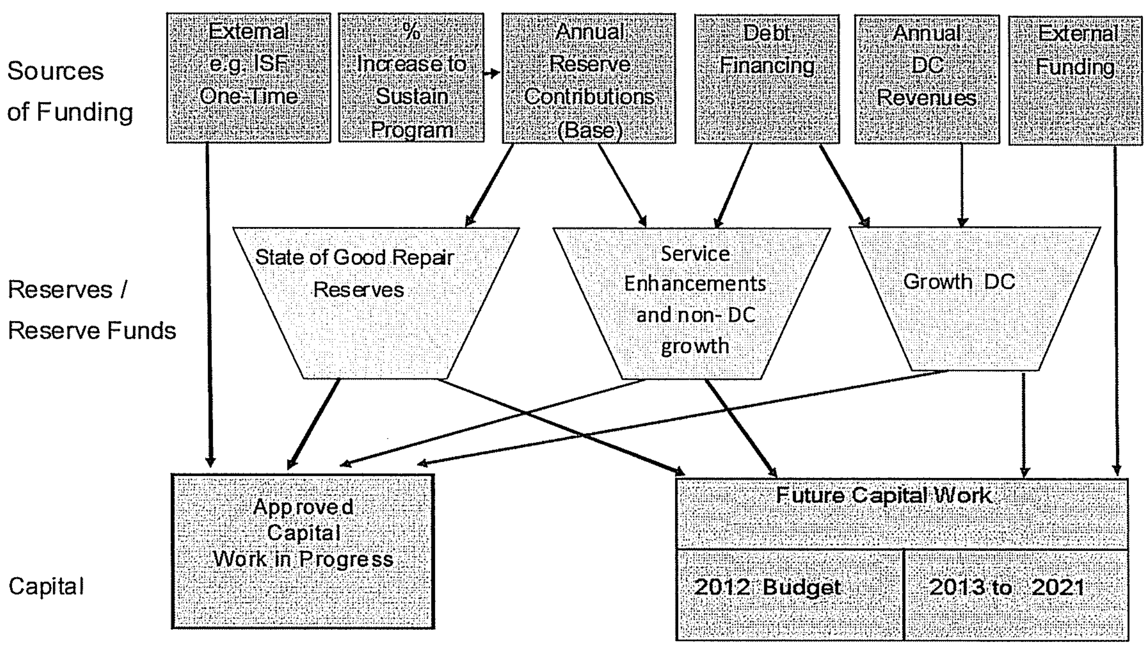
- In a report dated March 29, 2012, the CFO reported the Estimated Development Charge (DC) Rate Results and that external borrowing would continue to be required to fund the DC deficit. The DC Reserve balance as at December 31, 2011 was a deficit of $7.7 million (net of 2011 borrowing).
- While the DC reserve deficit has been temporarily funded by borrowing from non-DC reserves, both the overall magnitude of the borrowing requirement and the favourable 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.
- To more closely manage cashflow requirements and forecasted interest rate changes, two debenture issues are planned to raise up to the $400 million total principal requested. Mid–to-late June presents a good opportunity for a re-opening of our 10 year October 2011 issue followed by another debenture issuance in the mid-October to early November time frame.
- Area borrowing requirements are twofold. The City of Mississauga has requested debenture financing not to exceed $21.0 million, while the Town of Caledon has requested debenture financing of an amount not to exceed $3.0 million.

DISCUSSION

1. Background

Update of DC Reserve Funds (2012)
Since the 2007 DC By-law update, Council has been aware of the need to issue debentures primarily to fund the significant expansions planned to the water and wastewater systems. Regional Council has been provided regular updates since the adoption of the DC By-law 115-2007 and as part of the annual capital plan management process including annual updates on the status of the DC Reserve funds. The joint report from the CFO and Commissioner of Public Works titled "2012 Development Charges Study – Preliminary Findings" dated March 21, 2012 provided an updated forecast on both development charges rates and external borrowing requirements. The DC Reserve balance as at December 31, 2011 was a deficit of $7.7 million after applying the 2011 debenture proceeds, while the balance as at April 30, 2012 had increased to a deficit of $34.4 million. While this deficit has been temporarily funded from internal borrowings, the favorable borrowing rates make this the appropriate time to issue additional debt.

2012 Capital Plan Management
The sustainability of the Regional capital program requires a multi-faceted approach. As part of the 2012 budget presentation, Council was reminded of the comprehensive strategy to managing the Capital Plan (see figure below).



As previously noted, it will be necessary to continue to issue 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 $1.5 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. 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 $326 million.

2. Proposed Direction

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 system expansion, 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.

The Region has received requests for debenture financing from the City of Mississauga for an amount not to exceed $21.0 million and from the Town of Caledon for an amount not to exceed $3.0 million.

It is recommended to authorize the Region of Peel to issue debentures of up to the maximum of $400 million for the above noted purposes.

The following table summarizes the total debentures that the Region has issued for its own purposes (excluding area municipal borrowing and Peel Living mortgages):

Type of Debentures	Debentures Issued as at Dec. 31, 2011 ($ millions)
DC Related	$ 723
Non-DC Growth	$ 51
Region own-purpose debentures	**$ 774**

Should all the requested debt be issued, Peel would have approximately $1.15 billion of own purpose debentures outstanding on non-financial assets with a current replacement value of over $17 billion. This level of debt is well within the Region's revised Annual Debt Repayment Limit.

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

- interest rates continue to be 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;
- 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 from historical lows, 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.

CONCLUSION
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.

Norma Trim
Chief Financial Officer
and Commissioner of Corporate Services

Approved for Submission:

David Szwarc

D. Szwarc, Chief Administrative Officer

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c. Legislative Services