

Staff Report



To	Committee of the Whole
Service Area	Corporate Services
Date	Tuesday, April 6, 2021
Subject	2021 Debenture Issue

Recommendation

1. That capital projects identified in Table 2 of the 2021 Debenture Issue report, dated April 6, 2021, be approved for debt financing in the amounts as listed.
 2. That the City Treasurer be authorized to proceed with the marketing, through the City's financing agent, of debenture issues in the principal aggregate amount of not greater than \$115 million for terms not exceeding 20 years.
 3. That the 2021 associated debt servicing costs be approved to be funded from the City's applicable capital reserve funds in accordance with Table 3 in the 2021 Debenture Issue report, dated April 6, 2021.
 4. That the request for financing from the Guelph Cemetery Commission totaling \$2,000,0000 be approved in the form of a loan or guarantee, subject to satisfactory outcomes from the due diligence procedures as outlined in the 2021 Debenture Issue report, dated April 6, 2021, as determined by the City Treasurer and the City Solicitor.
 5. That staff be provided delegated authority to enter into appropriate agreements with the Guelph Cemetery Commission and/or with a lending agent, subject to the satisfactory outcomes of the due diligence procedures as outlined in the 2021 Debenture Issue report, dated April 6, 2021.
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Executive Summary

Purpose of Report

To obtain Council authorization to market debentures required to fund approved capital projects, specifically the Baker District Redevelopment, South End Community Centre and the F.M. Woods water treatment facility.

Key Findings

- The current interest rate environment is at historically low levels, providing an opportunity for attractive costs of financing for approved projects.
- The uncertainty created by COVID-19 around the world is leading to volatility in the debt markets, which requires both patience and flexibility in order to obtain the best financing outcomes.
- The City will require \$115 million in debenture funding over the next three years in order to complete the above-mentioned projects.

- Although City policy is to issue debentures after projects are essentially complete, the current market conditions provide an opportunity to reduce long-term cost of borrowing by issuing in 2021/2022.
- A request from the Guelph Cemetery Commission (GCC) has been received asking the City to issue \$2 million in debentures on their behalf. Staff have recommended an alternative approach, given the complexity of the City's proposed debenture plan.

Financial Implications

This debenture forms a significant part of the long-term capital strategy for funding capital projects that renew and replace aging infrastructure and serve to accommodate population growth in alignment with the City's Strategic Plan.

The overall costs of servicing this level of debt have been incorporated into the long-term capital plan presented to Council as part of the 2021 budget. All Council-approved Debt Management Policy metrics will continue to be met after this debenture.

The most significant financial risk of not moving forward with the debenture issuance, as proposed, is the interest rate climb over the medium term, which increases the overall cost of borrowing and negatively impacts the long-term financial forecasts.

Report

Background

In accordance with the City's [Debt Management Policy](#), the process for issuing debentures is as follows:

- Debt is approved by Council as a funding source during the annual capital budget process.
- Once construction of the capital project is essentially complete, Finance will prepare a report to Council requesting authorization to market a debenture issue through the City's financing agent.
- Once the debenture issue has been placed (i.e., sold), a debenture by-law is prepared including all details of the issue for Council approval.
- Settlement of the transaction then occurs and the City receives the funds within a few days.

Due to the historically low cost of borrowing, staff recommended proceeding with issuing a debenture to fund the South End Community Centre and the Baker District Redevelopment as part of the 2021 budget approval process. The City's normal process, as described above, is to wait until a project is essentially complete before proceeding with debenture issuance. In the current low interest rate climate, however, issuing the debenture in advance of spending minimizes cost of financing and risk of future interest rate escalations. Table 1 below shows the impact of moderate interest rate increases for the total cost of servicing \$115 million of debt funding.

Table 1 Interest Rate Increase Impacts on \$115 Million of Debentures ('000s')

Interest Rate	Cost over 20 years	Average Annual Cost
2.0%	\$25,532	\$1,276
3.0%	\$39,438	\$1,972
4.0%	\$54,081	\$2,704

Due to the magnitude of the debenture required, the City's financing agent is recommending an alternative approach from previous debenture issues. Typically, staff would seek approval of a specific amount and term and then the City's financing agent develops the appropriate product and places it in the market, providing the City with funding within a short period of time, typically 15 to 30 days. For this debenture, staff are seeking approval of a maximum amount and term, while allowing flexibility in timing and number of debenture issuances. The reasons for this approach are that the size and term of a debenture impact both the rate of interest achieved and also the ease of placing (i.e., selling) on the municipal debenture market. The City's financing agent advises the maximum municipal debenture has seldom exceeded \$75 million, and, under current conditions, longer term placements will likely result in higher interest rates or become difficult to sell.

Based on this, and to achieve the lowest cost of debt possible, the City is proposing to break the debenture into multiple issuances over the course of the next six to 12 months. Due to the ever-changing and volatile nature of the current market conditions, staff are seeking flexibility to go to market immediately when the financing agent assesses it to be the best opportunity. The financing agent can provide advice based on other products in the market regarding amount and term, enabling access to just-in-time decision-making within a maximum Council-approved envelope of \$115 million.

This approach will also allow staff to prepare all necessary legal and financial documents in advance and enable the City's financing agent to act quickly. The overall amount of the individual debentures will not exceed \$115 million as presented in Table 2; however, specifics will not be determined until such time as a debenture is placed in the market. At that time, staff will seek Council approval through debenture by-laws required to finalize the deals, including complete terms and cost of financing.

Requirement for funding

It is known that a minimum of \$115 million will be required over the next three years to fund significant investments in renewal of existing infrastructure and construction of new facilities.

The following projects, identified in Table 2, were previously approved as part of annual budget approvals, including the underlying requirement for debt funding. Further, Table 3 provides information on the source of revenue that will be utilized for debt repayment and financing costs.

Table 2: Debenture Funding by Project ('000s')

Council Approval Year	Project	Approved Debt Funding	Recommended 2021/2022 Debenture
2020 and 2021	F.M. Woods Water Treatment Plant (PN0693)	\$16,000	\$14,000
2017 and 2021	South End Community Centre (RP0290)	\$39,543	\$37,550
2018 and 2021	Baker District - Guelph Central Library (LB0028)	\$58,617	\$52,200
2019 and 2021	Baker District - Infrastructure (SS0025)	\$15,200	\$11,250
Total		\$129,360	\$115,000

Table 3 Debenture Funding Source ('000s')

Project	Total	Tax Funded	Rate Funded	Development Charge Funded
F.M. Woods Water Treatment Plant	\$14,000		\$14,000	
South End Community Centre	\$37,550			\$37,550
Baker District - Guelph Central Library	\$52,200	\$40,625		\$11,575
Baker District - Infrastructure	\$11,250	\$11,250		
Total	\$115,000	\$51,875	\$14,000	\$49,125

F.M. Woods (PN0693)

The F.M. Woods Water Treatment Plant and the water supply infrastructure associated with it are the City's most critical water assets. Up to 80 per cent of the City's water supply flows to, and is treated, stored, and pumped into the distribution system at this facility. The Treatment Plant requires significant upgrades to address aging infrastructure and level of service risks, information about which was shared with Council through the annual Drinking Water Quality Management System Audit.

Design work was approved as part of the 2019 budget with the balance of the required construction budget approved in 2020. Detailed design has been

completed and awarding of work is expected in 2021. Work is planned to be completed by 2024.

South End Community Centre (RP0290)

The South End Community Centre is a multi-use indoor recreation facility that will meet the needs of current and future populations, including from the development of the Clair-Maltby Secondary plan area.

Funding to complete a detailed design was approved in 2017, and the final design was completed in February 2021. Final site plan approvals will be provided by the second quarter of 2021. Prequalification of vendors is expected to occur by fall of 2021 with final awarding of construction contract planned for the fourth quarter of 2021. Construction is expected to be completed by 2024.

Baker District - Guelph Central Library (LB0028)

The new Guelph Central Library will replace the existing main branch, which has reached its end of life from a building condition perspective and does not meet the size and amenity needs of a 21st Century library or a growing population.

The new facility is being constructed as part of the Baker District Redevelopment project and, as approved in October 2020, it will be built as a stand-alone building on the south end of the block. Finalization of agreements with the site developer as well as detailed design is expected by the third quarter of 2021, with site work expected to begin in early 2022. Construction is expected to be completed by 2024.

Baker District – Infrastructure (SS0025)

The Baker District Redevelopment is a City-initiated development aimed at transforming the existing surface parking lot and adjacent properties fronting Upper Wyndham Street into a unique, mixed-use development with public and private components. This project includes the public components of the land and supporting infrastructure servicing required for the site development.

Work is planned to begin in early 2022 after finalization of the Urban Design Site Plan. Construction is expected to be completed by 2024.

Estimated Debt Financing Costs and Repayment Schedule

Currently it is estimated that the cost of borrowing will be between 1.5 and 2.5 per cent (inclusive of the issuing agent and legal fees). Due to COVID-19, the overall market for debt is sensitive and can fluctuate with any new information from governments around the world. Given this situation, the City's financing agent is recommending patience and flexibility in determining the best opportunity for the City.

Once a decision is made on the size and duration of the debentures to be placed, final costs of borrowing will be communicated and a payment schedule will be provided for final approval.

The cost of borrowing is projected to remain favourable in the short-term, given that both the Bank of Canada and the Federal Reserve in the United States (U.S.) continue current monetary policy in order to support the COVID19-impacted economy. Attachment-1: Interest Rate Outlook shows the expected interest rate environment for both Canada and U.S. government lending over the next eight quarters. Due to the extended low interest rate period, staff are recommending the

approval of the maximum limit while allowing timing and size of actual issues to be determined based on market conditions.

Annual Debt Repayment Limit (ARL)

In order for Council to provide debenture issuance authorization, the calculation of an updated debt and financial obligation limit, pursuant to subsection 4(1) of Ontario Regulation 403/02, has been completed and included in Attachment-2 to this report. Debt servicing payments resulting from this debenture issue and all approved, but not yet issued, debt will fall within the ARL prescribed by the Ministry of Municipal Affairs and Housing (MMAH). The City is currently using 21 per cent of its ARL, based on 2019 actuals.

Other Debt Limitations

The City's Debt Management Policy prescribes the debt capacity limitations that Council has approved for the organization, and they are more conservative than those prescribed by the MMAH. Further, the City's credit rating agency, Standard and Poor's (S&P), also uses a debt ceiling calculation in assessing the City's financial condition.

Table 4 Comparison to City Debt Management Policy limits

Debt limitation	Source	Maximum allowable	Forecasted 2022
Debt servicing as a percentage of operating fund revenue	City Debt Management Policy	10%	4.3%
Total debt as a percentage of operating fund revenue	City Debt Management Policy	55%	42.9%
Total debt as a percentage of operating fund revenue	S&P	30%	42.9%

While the City will not reach the allowable maximum leveraged position in 2022, this remaining debt capacity is forecasted to be used by 2026, as seen in Chart 1: Total Debt to Operating Revenue.

Cemetery Request for Funding

The City received a written request from the GCC on February 26, 2021, as included in Attachment-3, requesting that the City issue \$2 million of debentures on their behalf to support the GCC's capital plans. The GCC was created by the City of Guelph Act, 1919, which contained an agreement between the City, the Township of Guelph (now the Township of Guelph/Eramosa) and The Lord Bishop of Niagara and St. George's Church. The GCC's capital plans include the creation of additional interment rights inventory in Woodlawn Memorial Park's (WMP) natural burial area, increasing WMP's existing office space, and increasing cremation interment options by adding more columbarium walls and garden graves.

Given the described complexity of the debenture financing over a period of up to one year, staff believe incorporating this GCC request will limit the City's flexibility in term and also may result in reduced responsiveness to get to market. Further, the legal and regulatory requirements of debenture issuance are significant. For this reason, this is not the recommended approach to satisfy this request.

As an alternative approach, staff are comfortable with considering a loan arrangement, whereby the City would lend funds from those that are considered in

excess of the City's current needs. A further option could be to guarantee a loan that the GCC would seek from a financing institution, such as Infrastructure Ontario.

Any such debt arrangements come with increased financial risk for the City in the event that the GCC is unable to meet its obligations. The City has experienced the unfavourable impacts of these arrangements as recently as 2019 with Guelph Community Sports; however, the City has also had positive outcomes with Guelph Junction Railway Limited.

Given this risk, staff would recommend additional due diligence by the City in understanding the capital projects and the long-term business plans that would support the repayment of this investment. This process will require both Legal and Finance staff resourcing and, for this reason, staff are seeking to understand if Council is interested in pursuing a debt arrangement with GCC prior to work being undertaken.

Subject to Council approval, staff will perform due diligence and, subject to the agreement of the City Solicitor and the City Treasurer, enter into a financing agreement with GCC of no more than \$2 million. If the City were to enter into a direct loan agreement, the rate would be marked to the City's annual rate of return for excess funds, risk-adjusted, and the amortization would not exceed 20 years with a five-year renewal term. Due diligence would include the City requesting the following from GCC:

- Board-approved reports that document the capital requirements and budget.
- A board-approved business plan that outlines the GCC's ability to repay the financing obligations over the debt period through a cash budget projection, including revenue assumptions and non-recurring requirements (including, but not limited to, capital projects) during that period.
- Board-approved operating and capital budgets for past three years.
- Access to the past three years' audited financial statements.

Financial Implications

The 2021 debenture issuance is part of the long-term financial strategy required to achieve the objectives of the corporate capital plan, which supports the overall City Strategic Plan. The increased debt burden was planned and approved through previous capital budgets and is within the Debt Management Policy limits as visualized in Chart 1: Total Debt to Operating Revenue, and Chart 2: Debt Servicing to Operating Revenue, below.

Chart 1: Total Debt to Operating Revenue

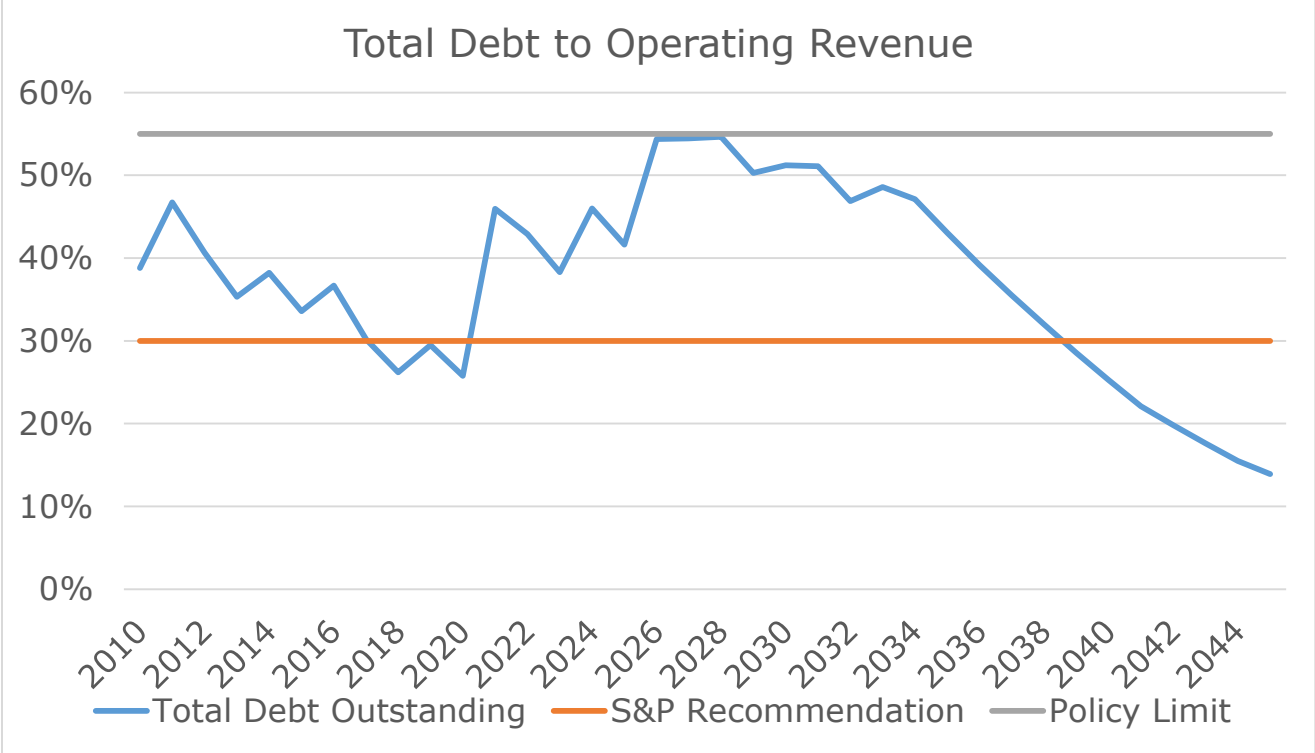
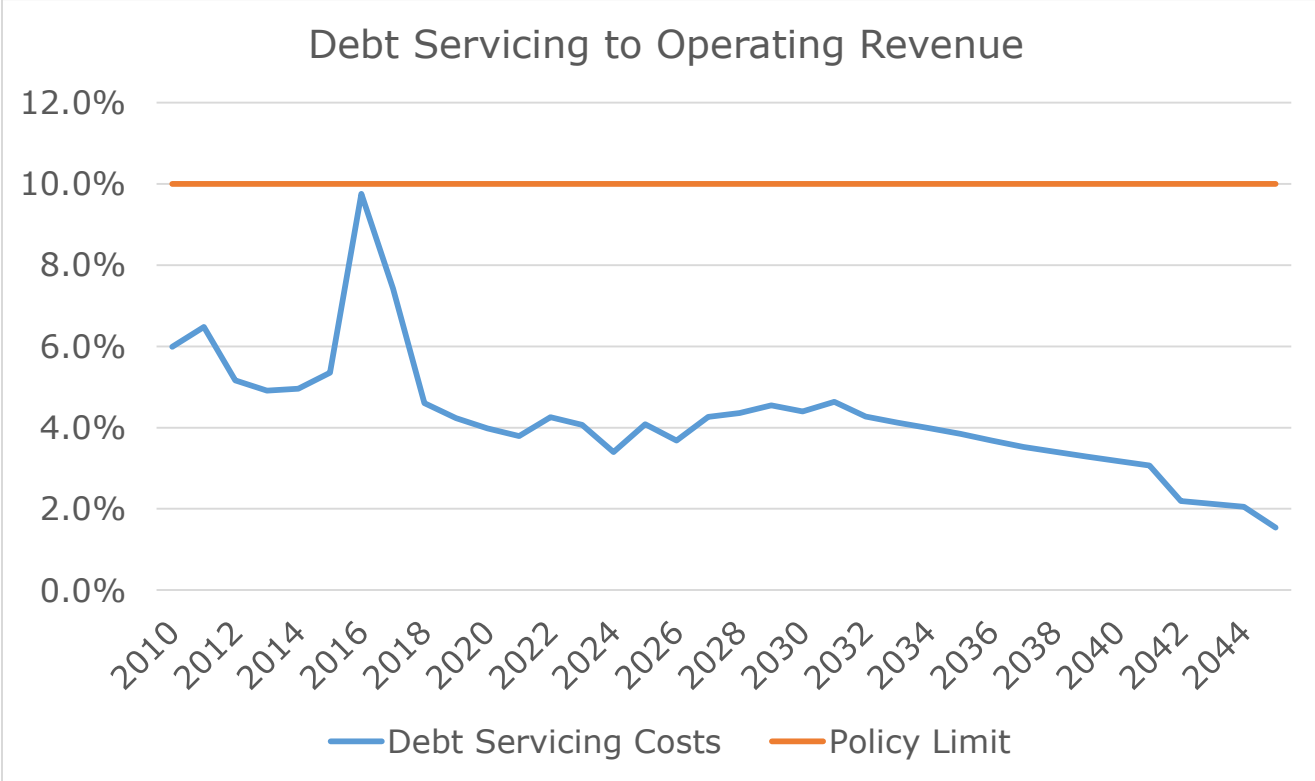


Chart 2: Debt Servicing to Operating Revenue



In August 2020, S&P reaffirmed the City's AA+ credit rating with a stable outlook based on a review of the current financial position and short-term plans, which included this proposed debenture. While an increase in debt burden and associated repayment costs can negatively impact the City's score, there are a number of mitigating factors, including robust financial management practices and the adoption of a multi-year budget.

The City's annual debt servicing costs will increase in 2021 based on the timing and size of the debenture. These costs were incorporated into the long-term capital funding model; however, they were not specifically budgeted for in 2021. Council is being asked to approve funding of the costs, from the identified sources in Table 3 above, in the range of \$850,000 to \$1,700,000 for 2021. This amount reflects interest only for 2021, which is dependent on timing, size and rate of the actual issuance(s) in 2021.

Consultations

Discussions with the Executive Team and Council during the development and planning of the 2021 budget solidified support for this debenture approval.

Strategic Plan Alignment

The prudent and responsible use of debt to fund large-scale capital investment is part of the City's long-term financial strategy in order to ensure continued delivery of core services. Minimizing the overall cost of financing eases the pressures on taxes and rates for residents as businesses. The use of debt allows for inter-generational equity when constructing assets that will provide services for decades to come. This strategy supports the Working Together for Our Future priority of the Strategic Plan by contributing to a long-term financial strategy that is achievable and affordable

The funding of all three projects identified allow for the development of new assets and renewal of aged infrastructure that respond to Guelph's growing and changing social, economic and environmental needs. This strategy supports the Building our Future priority of the Strategic Plan by supporting maintaining existing community assets and securing new ones

Attachments

Attachment-1 Interest Rate Outlook

Attachment-2 Annual Debt Repayment Limit

Attachment-3 Guelph Cemetery Commission Debenture Request Letter

Departmental Approval

None noted

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