CITY OF HAMILTON
CORPORATE SERVICES DEPARTMENT
Financial Planning, Administration and Policy Division

TO:	Chair and Members Audit, Finance and Administration Committee
COMMITTEE DATE:	July 11, 2024
SUBJECT/REPORT NO:	Proposed Amendments to By-law 12-094 – To Transition to the Canadian Overnight Repo Rate Average (CORRA) (FCS11079(b)) (City Wide)
WARD(S) AFFECTED:	City Wide
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SUBMITTED BY: **SIGNATURE:**	Brian McMullen Director, Financial Planning, Administration and Policy Corporate Services

RECOMMENDATION

That the draft By-law “To Amend By-law No. 12-094, being a By-law to authorize the borrowing of monies by way of bank loans in the principal amounts of $38,000,000 and $14,740,000”, attached as Appendix “A” to Report FCS11079(b), which has been prepared in a form satisfactory to the City Solicitor, be approved and enacted by Council.

EXECUTIVE SUMMARY

Amendments to By-Law 12-094, being a By-law “To authorize the borrowing of monies by way of bank loans in the principal amounts of $38,000,000 and $14,740,000”, passed by Council on April 25, 2012, are being recommended to reflect the amended Credit Facility Agreement dated February 28, 2024 and the amended Swap Transaction dated April 17, 2024, both updated due to mandatory Canadian regulatory requirements.

The By-law Amendment is attached as Appendix “A” to Report FCS11079(b). A version of By-law 12-094 which includes the proposed amendment shown in tracked changes is attached as Appendix “B” to Report FCS11079(b).

The amended Credit Facility Agreement and the amended Swap Transaction both reflect the outstanding loan’s new primary reference rate, the Canadian Overnight Repo Rate Average (“CORRA”), replacing the loan’s previous primary reference rate, Canadian Dollar Offered Rate (“CDOR”).

The mandatory change to CORRA from CDOR is a regulatory requirement further to the announcement on May 16, 2022 by Refinitiv Benchmark Services (UK) Limited that CDOR, the benchmark reference rate for Bankers’ Acceptances borrowings and other short-term lending products, will be discontinued as of June 28, 2024 and will be replaced with CORRA as the primary reference rate.

The Office of the Superintendent of Financial Institutions (“OSFI”), an independent agency of the Government of Canada which regulates financial institutions, requires banks and other financial institutions to transition CDOR to CORRA for loans, deposits and derivative contracts prior to June 28, 2024 (see the OSFI Letter entitled OSFI update on Canadian Dollar Offered Rate transition, dated October 24, 2023, attached as Appendix “C” to Report FCS11079(b)).

The effect of both the amended Credit Facility Agreement dated February 28, 2024 and the amended Swap Transaction dated April 17, 2024 does not change the total borrowing costs originally contracted in 2012 for the outstanding loan. The City will continue to pay a fixed rate of 3.16% on the outstanding borrowing until its maturity on May 10, 2027. A schedule of the remaining principal and interest payments for the outstanding loan, as of May 8, 2024, is attached as Appendix “D” to Report FCS11079(b).

Staff undertook and completed the regulatory requirement to amend both the Credit Facility Agreement and the Swap Transaction to reflect the change to CORRA after considering four possible alternatives, as follows, details of which are given on Page 5 of Report FCS11079(b). From the perspective of total borrowing costs, none of the four alternatives are favourable for the City.

i) Close out both the outstanding loan and the Swap Transaction.
ii) Close out the Swap Transaction but retain the outstanding loan.
iii) Close out both the outstanding loan and the Swap Transaction. Refinance by undertaking new borrowing with a serial debenture at current market rates.

iv) Close out both the outstanding loan and the Swap Transaction. Refinance by undertaking new borrowing with a new variable interest rate loan and a new swap transaction at current market rates.

Alternatives for Consideration – See Page 5

FINANCIAL – STAFFING – LEGAL IMPLICATIONS

Financial: Not Applicable.

Staffing: Not Applicable.

Legal: Legal Services has prepared the necessary by-law amendment to reflect the changes to By-law 12-094 recommended in Report FCS11079(b).

HISTORICAL BACKGROUND

Two variable interest rate bank loans, one for $38 M with a term of 15 years (“$38 M loan”) and another for $14.74 M for a term of 5 years (“$14.74 M loan”) were undertaken in 2012 pursuant to the authority set out in By-law 12-094 with the Royal Bank of Canada by way of Bankers’ Acceptances and based on the CDOR, the primary reference rate for Canadian Bankers’ Acceptances.

A Canadian Bankers’ Acceptance is a particular money market instrument, a short-term promissory note issued by a borrower (usually a corporation) and stamped by an accepting or lending bank, whereupon the accepting bank guarantees and becomes fully liable for the payment of principal and interest of the note.

In addition, pursuant to the authority set out in By-law 12-094, in order to provide for the reduction of interest rate risk given the variable interest rate based on CDOR, the $38 M loan and the $14.74 M loan were each separately overlaid with an interest rate exchange agreement (a “swap transaction”), a type of derivative contract.

For the $38 M loan, a 15-year swap transaction was entered into that converted the variable interest rate based on CDOR to a fixed interest rate of 3.16%. Similarly, for the $14.74 M loan, a five-year swap transaction was entered into that converted the variable interest rate based on CDOR to a fixed interest rate of 2.13%.

The $14.74 M loan expired and was paid in full in 2017.

The $38 M loan, together with the accompanying swap transaction, remain outstanding and both will expire on May 10, 2027. As of May 8, 2024, the outstanding principal balance of the $38 M loan is $10,137,000. Appendix “D” attached to Report FCS11079(b) shows the remaining scheduled principal and interest payments as of May 8, 2024.

POLICY IMPLICATIONS AND LEGISLATED REQUIREMENTS

The mandatory change to CORRA from CDOR is a regulatory requirement. As announced on May 16, 2022 by Refinitiv Benchmark Services (UK) Limited, the CDOR, being the benchmark reference rate for Bankers’ Acceptance borrowings and other short-term lending products, will be discontinued as of June 28, 2024 and can be replaced with CORRA as the primary reference rate.

OSFI requires banks and other financial institutions to transition CDOR to CORRA for loans, deposits and derivative contracts prior to June 28, 2024 (see the OSFI Letter entitled OSFI update on Canadian Dollar Offered Rate transition, dated October 24, 2023, attached as Appendix “C” to Report FCS11079(b)).

RELEVANT CONSULTATION

Legal Services has prepared a by-law amendment to reflect the changes to By-law 12-094 recommended in Report FCS11079(b).

ANALYSIS AND RATIONALE FOR RECOMMENDATION

Further to the announced change from CDOR to CORRA, OSFI requires banks and other financial institutions to transition CDOR to CORRA for loans, deposits and derivative contracts prior to June 28, 2024.

Accordingly, as requested by the Royal Bank of Canada, the City undertook and completed the transition to CORRA on May 8, 2024. An amended Credit Facility Agreement dated February 28, 2024 was executed which updated the outstanding $38 M loan based on Bankers Acceptances and CDOR to a variable rate bank loan based on CORRA, effective on May 8, 2024.

Additionally, the overlaying swap transaction to the $38 M loan was amended to CORRA, effective on May 8, 2024, to maintain a match with the changes made to the loan. An amended swap transaction dated April 17, 2024 was executed and the resulting fixed rate was maintained at 3.16%.

The effect of the both the amended Credit Facility Agreement dated February 28, 2024 and the amended Swap Transaction dated April 17, 2024 does not change the total borrowing costs originally contracted in 2012 for the outstanding loan over the remaining term of the loan. The City will continue to pay a fixed rate of 3.16% on the outstanding borrowing until its maturity on May 10, 2027.

It is recommended that the language contained in By-Law 12-094 be amended to reflect the language contained in the updated Credit Facility Agreement for the outstanding $38 M loan now based on CORRA and to reflect the language contained in the amended swap transaction now also based on CORRA.

ALTERNATIVES FOR CONSIDERATION

In considering the alternatives to the transition of both the $38 M loan and accompanying swap transaction to CORRA, we compared the alternatives to the status quo situation as of the close on May 8, 2024 (the most recent scheduled payment date on the $38 M loan).

For the status quo situation, the outstanding principal balance is $7,604,000, the fixed interest rate is 3.16% and the total interest cost over the remaining term is $481,170.26. We also note that the market value of the swap transaction is $220,000 in the City's favour as of May 8, 2024.

There are four alternatives to the status quo situation for consideration as follows and summarized in Table 1, Borrowing Costs for Alternatives:

Table 1 – Borrowing Costs for Alternatives

	Alternatives for outstanding $38 M loan and swap contract				
	Status Quo	Alternative I	Alternative II	Alternative III	Alternative IV
Description	Retain loan and swap	Payout loan and close swap	Payout loan and close swap; Refinance with serial bond	Retain loan but close swap	Payout loan and close swap; Refinance with new variable rate loan + swap
Fixed interest rate *	3.16%		4.66%	variable interest rate	5.15%
Total Principal Repayment ($)	$ 7,604,000.00	$ 7,604,000.00	$ 7,604,000.00	$ 7,604,000.00	$ 7,604,000.00
Total Interest Borrowing Cost ($)	$ 481,170.26		$ 709,573.86	variable interest rate	$ 784,185.70
Total Interest Earned ($)**		$ 834,434.50			
Funds from closing the swap		$ (220,000.00)	$ (220,000.00)	$ (220,000.00)	$ (220,000.00)
Total Borrowing Cost for City ($)	$ 8,085,170.26	$ 8,218,434.50	$ 8,093,573.86	unknown because rate is variable	$ 8,168,185.70
Net $ comparison to Status Quo		$ (133,264.24)	$ (8,403.60)	unknown because rate is variable	$ (83,015.45)
$ Favorable to City ?		No	No	No	No

* rates for Alternatives are indicative as of May 2024

** bank account earns 5.48%

Alternative I: Close out both the $38 M loan and the swap transaction.

The opportunity cost of deploying the funds that would be used to pay out in full the loan in the bank account is $834,434.50 (assuming no change in the interest rate earned in the City's bank account) whereas the interest cost (based on 3.16%) on the outstanding principal balance of $7.6 M is $481,170.26, a difference of $353,264.24. After accounting for the $220,000 cash from paying out the swap transaction, the net result would be an additional interest cost of $133,264.24 compared with the status quo.

Alternative II: Close out the swap transaction but retain the $38 M loan.

Retaining only the $38 M loan (without the swap) would result in interest rate risk because the interest rate is variable. This is neither a prudent nor a recommended alternative.

Alternative III: Close out both $38 M loan and swap transaction. Refinance the projects by undertaking new borrowing with a serial debenture at current market rates.

Projects financed with new debt at the current indicative market rate of 4.66% for a serial debenture would result in interest costs of $709,573.86 compared with the status quo interest costs of $481,170. After accounting for the $220,000 from closing out the swap, the net result is an additional interest cost of $8,404 compared with the status quo.

Alternative IV: Close out both the $38 M loan and swap transaction. Refinance the projects by undertaking new borrowing with new variable interest rate loan and new swap transaction at current market rates.

Projects financed with new debt at current market rates of 5.15% for a new CORRA / swap structure would result in interest costs of $784,186, compared with the status quo interest costs of $481,170. After accounting for the $220,000 from closing out the swap, the net result is an additional interest cost of $83,016 compared with the status quo.

In conclusion, from the perspective of total borrowing costs, none of the four alternatives are favourable for the City. Therefore, staff undertook and completed the regulatory requirement to amend both the Credit Facility Agreement and the Swap Transaction to reflect the change to CORRA.

APPENDICES AND SCHEDULES ATTACHED

Appendix "A" to Report FCS11079(b) – Proposed Amendments to By-law 12-094

Appendix "B" to Report FCS11079(b) – By-law 12-094 with proposed amendments included as tracked changes

Appendix "C" to Report FCS11079(b) – Letter from The Office of the Superintendent of Financial Institutions (OSFI) Canada, OSFI update on Canadian Dollar Offered Rate transition, dated October 24, 2023

Appendix "D" to Report FCS11079(b) – $38 M Loan Payment Schedule as of May 8, 2024

RM/GB/dt