Hamilton

CITY OF HAMILTON

CORPORATE SERVICES
Financial Planning and Policy Division
Investments Section

TO: Chair and Members Audit, Finance and Administration Committee	**WARD(S) AFFECTED:** CITY WIDE
COMMITTEE DATE: January 18, 2012	
SUBJECT/REPORT NO: Authority to Negotiate and Place Variable Rate Loan and Debenture(s) (FCS11079(a)) (City Wide)	
SUBMITTED BY: Roberto Rossini General Manager Finance & Corporate Services Department **SIGNATURE:**	**PREPARED BY:** Gerald T. Boychuk 905-546-4321

RECOMMENDATION

(a) That the General Manager, Finance & Corporate Services, be authorized to negotiate terms and placement of a variable rate loan and debenture issue(s) in an amount of $38,000,000 and $14,740,000 to refinance the outstanding balance of By-law 01-245 through the Royal Bank of Canada, and $42,000,000 be funded through a debenture issue.

(b) That the General Manager, Finance & Corporate Services, be directed to negotiate and execute all required documentation satisfactory to the City Solicitor.

(c) That a By-law(s) be passed authorizing the variable rate loan and debenture(s) as negotiated and passed in accordance with (a) and (b) above.

EXECUTIVE SUMMARY

At the September 14, 2011 Council meeting, Report FCS11079 - *Authority to Negotiate and Place a Debenture(s)* was approved. While the report recommended placement of a *debenture issue(s)*, Report FCS11079(a) identifies alternative financing possibilities with an intended outcome of a lower cost to borrow and flexible financing terms. Report FCS11079 identified the need for an $80,000,000 debenture(s) as well as an additional $14,740,042 to refinance a debenture(s) approved and issued in 2001 and matured in October 25, 2011. A five year debenture(s) will be required to finance a balloon payment, with the debt being retired at the end of a five year term,.

In reviewing the financing possibilities, three options were contemplated as follows:

1) Public Issue Debenture(s):
   - Less favourable due to market conditions which do not accommodate 15 year debentures
   - Higher all-in-cost of financing

2) Infrastructure Ontario Loans:
   - Can accommodate a 15 year term borrowing term for new projects
   - Cannot accommodate the re-financing of the By-law 01-245, as these are projects prior to 2004.
   - All-in-cost of financing is lower than public issue debentures, but higher than a bank loan.

3) Royal Bank of Canada (RBC) bank loan as outlined in the <u>Municipal Act</u>, 2001 Ontario Regulation 276/02:
   - Can accommodate flexible terms and repayment schedules if the bank grants the total credit exposure.
   - All-in-cost of financing is the lowest, approximately at 20-40 basis points less than an Infrastructure Ontario loan or a public issue debenture.

With respect to option 3, the recommended option, the City meets the requirements of the <u>Municipal Act</u> with a higher than AA low credit rating and the RBC has approved a term credit facility increase of $80,000,000 and $14,740,000. The variable loan rate spread has been approved at 0.61% per annum on the 15 year term and 0.29% per annum on the five year term, respectively over the then current Banker's Acceptance (BA) rate for 30 days. The City and RBC concurrently are to enter into an Interest Rate exchange agreement which will then, depending upon the swap cost, <u>fix the rate and terms of repayment for the increased debt facility</u>. The repayment terms are to be structured with annual principal payments of equal amounts and semi-annual interest payments, modelling a serial debenture issue and being a deemed debenture under Ontario Regulation 276/02 with appropriate by-laws to be executed by the Mayor, City Clerk and the Treasurer as required.

The process of fixing a rate on the repayment schedule is accomplished through a swap rate which is set at the time of the commitment. This rate is set by the markets and is variable, but once set is effective for the term of the loan. If the swap rate was 2.05% for 15 years, the all-in-cost for a 15 year term loan would be the sum of the swap rate, plus the spread (2.05%+0.61%) or 2.66%. The repayment schedule would require an interest payment every six months and equal principal payments annually, except the last payment may be marginally higher to equate to full principal repayment.

Operationally, the City is making a variable rate loan through the issuance of 30 day BA's. The issued BA securities are purchased in total by the Royal Bank's capital markets group and re-sold in the market place or kept by RBC. The City receives the issue face amount credited to the City's RBC bank account. On a monthly basis going forward for the term of the loan, a debit and offsetting credit are entered in the bank account. Through a swap agreement, the monthly transactions are swapped at a stated cost into a fixed payment schedule. Assuming an all-in-cost of 2.66%, the repayment schedule would detail a semi-annual coupon payment of 1.33% payable and a principal payment annually reducing the loan amount and interest payable to final maturity and payout. The all-in-cost is subject to change in the swap rate(s), but once committed it is fixed for the term of the loan(s).

As outlined in FCS11079, the additional $20,454,000 may be required to be issued to refinance debentures approved and issued in 2001 and maturing October 25, 2011, under By-law 01-245. It was noted that $5,713,958 of the $20,454,000 is on behalf of the Hamilton-Wentworth District School Board ("HWDSB"), for which the HWDSB will be responsible for the debt costs. The City is looking to issue debentures totalling $14,740,042 for the City's portion only ($20,454,000 less $5,713,958).

The recommended financing option is an option that is supported through the Municipal Act, 2011 and has been exercised by other agencies, including the City of Ottawa, in an effort to realize the benefits identified previously.

Alternatives for Consideration – See Page X or Not Applicable

FINANCIAL / STAFFING / LEGAL IMPLICATIONS (for Recommendation(s) only)

Financial: The variable rate loan and deemed debenture(s) as per FCS11079(a) are borrowings to finance capital projects and the rollover of By-law 01-245.

Staffing: None

Legal: Outside legal counsel is required in order to execute the issuance of the variable rate loan, swap agreements, deemed debentures and appropriate By-law(s).

HISTORICAL BACKGROUND (Chronology of events)

In September 2011, Council approved Report FCS11079 - *Authority to Negotiate and Place a Debenture(s)*. While the report recommended placement of a *debenture issue(s)*, Council did not provide authority to negotiate terms and placement of a variable rate loan. In order to realize favourable borrowing costs and access for flexible borrowing terms, FCS11079(a) seeks authority to negotiate terms and placement of a variable rate loan.

POLICY IMPLICATIONS

Not applicable.

RELEVANT CONSULTATION

City Legal Department
City of Ottawa
External Legal - Gardiner Roberts, LLP
Royal Bank of Canada
University of Guelph

ANALYSIS / RATIONALE FOR RECOMMENDATION

(include Performance Measurement/Benchmarking Data, if applicable)

Financing through a variable loan agreement swapped into fixed rate and term “deemed” debenture(s), as outlined in Ontario Regulation 276/02, provides a flexible borrowing tool at a significant cost advantage.

The Royal Bank has agreed to enhance the City’s credit facility by $94,740,000 to facilitate this loan. The City’s credit facility of $65 million on a demand loan basis remains intact. The fact that the City and the RBC credit ratings are both AA low or higher enables this bank loan under Ontario Regulation 276/02.

The use of a public issue debenture(s) for 15 years is not acceptable to the market. The market only funds up to 10 years efficiently. At times a 15 year amortizing debenture issue is acceptable to the market at an increased rate at 12-14 basis points. However, the domestic market for this type of financing is not currently active.

Infrastructure Ontario does finance municipalities by re-lending at a spread of over the Province of Ontario's basic borrowing rate for the term. They do accommodate financing of longer terms at generally better rates than available in the public markets for both serial and amortizing debentures(s). However, they do not finance projects that were started prior to 2004. Infrastructure Ontario, while having better all-in-cost of financing in general than a public issue does not, at this time, equal the all-in-cost that can be achieved through a variable loan agreement swapped to a fixed rate.

A variable rate loan agreement swapped into deemed debenture(s) allows full flexible financing of the desired $94,740,000 over a 15 year term. The indicated rates for a 15 year term on December 13, 2011 were as follows:

		15 Year Serial	15 Year Amortizer
Option 1	Public Issue	3.28%	3.56%
Option 2	Infrastructure	3.17%	3.27%
Option 3	**RBC Variable Loan**	**2.94%**	**----**

The pricing and all-in-cost of a variable rate swapped bank loan is highly competitive and generally lower than the other two methods of financing. Based on the rates quoted above for a 15 year serial equivalent and $52,740,000 financed, a variable rate loan is 23 basis points and 34 basis points lower than Infrastructure Ontario and a public debt issue, respectively. **This translates into average annual interest savings of approximately $60,651 compared to Infrastructure Ontario and $89,658 compared to a public debt issue. Total interest savings over the 15 years would be $909,765 or $1,344,870, respectively.**

In summary, a variable rate swapped loan would accommodate the City's financing needs fully and result in significant interest savings. The Royal Bank and the City as counter parties to a variable rate loan agreement qualify under Ontario Regulation 276/02. The regulation restricts the amount that can be financed through this means to 15% of all outstanding debt at the time of issue; therefore, the amount to be issued is constrained to the rollover of By-law 01-245, plus $38 million in new projects. The balance of $42 million in new projects authorized by FCS11079 with a 15 year term will be funded through Infrastructure Ontario or a public debt issue.

ALTERNATIVES FOR CONSIDERATION

(include Financial, Staffing, Legal and Policy Implications and pros and cons for each alternative)

None

CORPORATE STRATEGIC PLAN (Linkage to Desired End Results)

Focus Areas: 1. Skilled, Innovative and Respectful Organization, 2. Financial Sustainability, 3. Intergovernmental Relationships, 4. Growing Our Economy, 5. Social Development, 6. Environmental Stewardship, 7. Healthy Community

Financial Sustainability

- Delivery of municipal services and management capital assets/liabilities in a sustainable, innovative and cost effective manner
- Address infrastructure deficiencies and unfunded liabilities
- Greater financing flexibility through bank loans.

APPENDICES / SCHEDULES

None