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REPORT TO THE FINANCE COMMITTEE
MEETING OF WEDNESDAY, NOVEMBER 03, 2021

SUBJECT **Municipal Finance Authority – Debt Issuance Terms**

ISSUE SUMMARY

Report on recent changes to debt issuance terms by the Municipal Finance Authority of British Columbia (MFA).

BACKGROUND

When compared to other Canadian provinces, British Columbia is unique in centralizing local government investments and debt financing through a single public entity. The *Local Government Act*, *Community Charter*, and *Municipal Finance Authority Act* require all long-term debt for local governments in BC be issued through the MFA.

The MFA was created in 1970 to serve local governments throughout the province by pooling borrowing and investment needs, enabling access to a broad range of low cost and flexible financial services regardless of community size. The MFA operates under the governance of a Board of Members appointed from regional districts and operates independently of the provincial government.

All long-term borrowings are contractual agreements between the MFA and regional districts. Additionally, all 160 municipalities are members in 1 of 28 regional districts. Each regional district is liable to make debt repayments to the MFA; in turn, member municipalities are liable to make repayments to the regional district. The responsibility for initiating legislative approval, setting borrowing terms, requests and repayment lies with the entity requesting financing (i.e. municipality or regional district). However, all members of the regional district are jointly and severally liable for all outstanding debt in the event of default.

As it relates to borrowing, the role of local government staff is to plan service delivery through operating and capital budgets; identifying revenue and financing requirements. As input variables into the planning process, staff rely on the MFA debt placement model, indicative borrowing rates, and various flexible repayment options.

Through staff recommendation, local government financing is authorized upon approval of a loan authorization bylaw, requiring public consent, a resolution of council (municipalities), and a regional district security issuing bylaw. Twice annually, long-term financing on behalf of all local governments is undertaken by the MFA. Financing requests are pooled and funded in the Spring and Fall by selling bonds in capital markets.

MFA bonds are highly attractive and considered benchmark Canadian municipal bonds due to the system of bylaws in addition to the MFA's direct and unfettered property taxation power. These legislative safeguards ensure MFA's credit rating (measured by Moody's, Fitch and Standard & Poor) is consistently maintained AAA; the highest level of creditor confidence, resulting in lower borrowing rates.

The MFA debt model in capital markets considers both rate and volume of financing required, and is issued on terms ranging between 5 to 30 years. The current approach involves an initial fixed 10-year term, after which refinancing is placed at 5-year terms until maturity of debt is reached. Annual interest payments are made by the regional districts, but bond holders do not receive principal until the re-financing date (MFA bonds are bullet debentures). As such, the MFA maintains a “sinking fund” which invests principal payments. Investment income earned by the sinking fund is credited to each local government in the bond issue. The benefit of this system is a reduced overall cost of financing due to actuarial earnings. If the MFA earns above the actuarial rate assumption, it is possible the loan will be forgiven ahead of schedule.

Through the July 2021 Finance Committee and Board meetings, a security issuing bylaw was introduced, read three times, and adopted for the fall borrowing. The CRD had a 30 year, $1.26 million, long term debt placement for the Magic Lake Estates Wastewater System, while the Township of Esquimalt had a 30 year, $35 million placement for a public safety building.

In August 2021, the MFA introduced a longer initial fixed debt term (20 vs 10 years), requesting local governments with long-term debt in the Fall borrowing consent to the revised model. The report summarizes the impact of this change and rationalizes declining this option for the CRD.

IMPLICATIONS

Financial Implications

For the 2021 fall borrowing, the MFA introduced the option of using a longer initial fixed debt term. Local governments who had authorized debt where the term was 20 years or greater were asked to consent to this new option and a fixed 20 year initial term and rate.

The CRD had submitted a 30 year debt issuance for the Magic Lake Sewer service. This borrowing was expected to be financed for an initial 10 year term, followed by 5 year refinancing options in each of years 10, 15, 20 and 25. Under the new option, debt would be placed initially at 20 years, followed by 5 year refinancing options in each of years 20 and 25.

Following a modelling exercise summarized in Appendix B, and detailed below, staff declined the MFA option for the Magic Lake Estates Wastewater System borrowing.

Analysis

Staff created a financial model to compare the current initial 10 year fixed model with the new initial 20 year fixed option. For ease of analysis, a $1 million dollar long-term borrowing was evaluated. The actuarial rate was held at 2.25% (current experience) to ensure earnings and principal payments remained a constant. To avoid speculation of future interest rates, each option was analyzed using CRD planning assumption rates with a reasonable premium to account for economic conditions.

Appendix B summarizes the financial analysis and modelling by staff. The analysis shows the current 10 year initial option would cost $117,500 (approximately 30%) less than the new initial 20 year term per $1 million borrowed. A financial break-even analysis shows refinancing rates would have to rise from today by almost double, between years 10 and 20, to justify switching to the 20 year initial term.

Additionally, the 20 year initial term comes with reduced flexibility for local governments in managing debt. Renewal periods allow borrowers the option to repay the outstanding balance to avoid further interest charges; an option exercised by CRD and CRHD services.

Finally, in a rising rate environment, the actuarial rate is subject to review by the MFA and could be increased, providing a greater credit to debt repayment. In the 20 year initial term, actuarial rate would more likely remain fixed during the period, foregoing benefit from actuarial gains in years 11 through 20.

Other Considerations

Revenue requirements can fluctuate upon each renewal period after the 10 year initial term, either increasing or decreasing with interest rate changes. Where revenue stability for the local government is necessary, the 20 year initial term would have the same payments through the initial placement period. As a result, principle and interest costs would be fixed. As illustrated in the financial analysis above, cost certainty translates into a rate premium and possibly higher total financing cost.

The need for borrowing is identified in service and asset planning. The optimal use of borrowing is defined by the Capital Reserve Guidelines (received in July 2021 by Board through Finance Committee) where the Debt Term Guidelines (October 2019 by Board through Finance) recommends amortization period to balance cost of borrowing with affordability. In alignment with these guidelines, and the financial analysis above, staff did not consent to the 20 year initial debt term option. Staff will continue to monitor MFA indicative rates, perform scenario analyses, evaluate options, and recommend the best risk-cost-benefit alternative to the CRD or CRHD in aligment with offerings from MFA.

Legislative Implications

The MFA debt model through August 2021 was considered the standard methodology and has been incorporated into CRD loan authorization approvals and the Magic Lake Sewer referendum process. Documents prepared for public consultations, including analysis of cost implications, were widely shared with the community and based on MFA indicative interest rates with a 10 year initial term, and subsequent 5 year renewals.

On November 23, 2019, a referendum vote was held for the Magic Lake Estates wastewater system; the advertising notice is included in Appendix A. An excerpt of the borrowing plan states:

> *Taxation Impact*
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> *The 30-year loan authorization period may ultimately result in an additional estimated parcel tax of $496, based on borrowing up to $6,000,000 for the project. This rate is for illustrative purposes only and the actual parcel tax will be based on the amount borrowed and the interest rate at time of borrowing. The interest rate may also change each time the loan is refinanced (after approximately 10 years and then every 5 years thereafter).*

Consenting to an initial 20 year term would have resulted in a departure from information provided in the public decision-making and approval process.

CONCLUSION

Recent changes to debt issuance terms offered by the Municipal Finance Authority of British Columbia (MFA) have been reviewed for consideration. The change to debt term issuance was analyzed and the recommendation developed to decline the new debt issuance term for the Magic Lake Estates Wastewater System borrowing. Staff will continue to review new options when presented for consideration.

RECOMMENDATION

The Finance Committee recommends to the Capital Regional District Board:
That the Municipal Finance Authority – Debt Issuance Terms report be received for information.

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Concurrence:	Robert Lapham, MCIP, RPP, Chief Administrative Officer

ATTACHMENT(S)
Appendix A: Magic Lake Notice Assent Voting Opportunity
Appendix B: Rate Analysis