RESPONSE TO NOTICE OF MOTION ON DEBT COST REDUCTION

EXECUTIVE SUMMARY

In response to a Notice of Motion introduced by Councillor Chabot on 2013 April 22, and further discussed on 2013 July 22, this report outlines options for using $52 million tax room to reduce debt borrowing costs primarily, but not limited to the Municipal Sustainability Initiative (MSI). A specific scenario relating to the MSI program described by Councillor Chabot is outlined including certain benefits and limitations.

ADMINISTRATION RECOMMENDATION(S)

Administration recommends that Council receive this report for information.

PREVIOUS COUNCIL DIRECTION / POLICY

On 2013 April 22, Report C2013-0330, Council approved the following:

1. Engage in consultation and share with citizens of Calgary on five options to allocate the $52 million as follows: Create a dedicated Transit Capital Fund; Reduce the tax rate differential between residential and non-residential properties; Create a "revitalizing Our Communities Fund"; Reduce debt; or, Reduce the overall increase in property tax rate for all residential tax payers.
2. A motion arising was also brought forward by Councillor Chabot, for Administration to report back through the Priorities and Finance Committee with options on the best way to utilize these funds ($52 million) to reduce borrowing costs primarily, but not limited to, the Municipal Sustainability Initiative, no later than 2013 July.

On 2013 July 22, the report on the $52 million engagement was presented to Council. The report, C2013-0614, was prepared by Administration and outlined the direction Administration received from Council, the engagement process undertaken, and the method used to organize and theme the verbatim comments received from citizens during the engagement process. The debt reduction option was among the information included.

On 2013 July 22, Council approved a recommendation, referencing Councillor Chabot's 2013 April 22 motion, directing Administration to report in November with options on the best way to utilize the $52 million to reduce borrowing costs primarily, but not limited to the MSI.

BACKGROUND

Reducing debt was one of five options identified by Council when it directed Administration to engage in a short consultation process to gather feedback from the citizens of Calgary to allocate $52.1 million additional annual revenue from tax room vacated by the Province. It was identified that reducing The City's debt by $52 million a year for five years would enable The City to reduce a portion of its existing debt or avoid assuming new debt for infrastructure projects previously approved by Council. Lower debt would generate annual interest cost savings of approximately $1.6 million per year for The City. These funds would be available for uses such as enhancing delivery of City services or reducing the amount of funds required to be collected from other sources such as property taxes. Further information reflecting the information used in the engagement process can be found in the Attachment.

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Originally, The City anticipated receiving $3.3 billion from the MSI grant program to fund infrastructure. The duration of the original program was for 10 years from 2008 to 2017. Subsequent to the implementation of the program, the Province extended its duration, resulting in significantly reduced annual amounts being received by The City. The City still faced significant commitments to deliver critical infrastructure. To ensure the timely delivery of these infrastructure projects and to manage the effects of the Provincial funding shortfall, The City utilized bridge financing. Provincial MSI rules allowed The City to bridge finance up to 50% of the total anticipated funds ($1.65 billion) and incur eligible interest costs up to 7% of the total anticipated funds ($231 million). Prior to 2013 April, The City's forecast MSI bridge financing and associated interest costs were both below established limits at approximately $1.4 billion and $205 million respectively.

INVESTIGATION: ALTERNATIVES AND ANALYSIS

In 2013 April, the Province provided the 2013 MSI funding which was lower than expected. Administration recalibrated the MSI funding schedule and this resulted in the need for approximately $190 million more bridge financing. The imputed interest cost associated with issuing multi-term bullet debt for the $190 million is estimated to be $17 million. These funding changes have resulted in The City reaching the total amount of available bridge financing. The incremental interest cost has moved The City closer to the 7% limit of total available funds.

The engagement process provided certain information regarding debt reduction as a potential option for the use of the $52 million tax room. However, a specific proposal by Councillor Chabot regarding this option was not addressed. This proposal considered utilizing a portion of the $52 million tax room to fund the $17 million in incremental interest associated with issuing $190 million in bullet debt for additional bridge financing required due to the MSI funding schedule change. This proposal does not reduce the amount of bridge financing debt required, but it does reduce the interest cost within the MSI program envelope, over the next few years. This proposal would reduce the amount of interest charges to the MSI program by $17 million, thereby making these funds available for other MSI projects, subject to Council's approval to redirect the funds from the MSI contingency (which is the source of funding for paying these interest costs).

This proposal would not reduce the total amount of MSI borrowing nor provide for additional bridge financing since The City is currently at the 50% bridge financing limit. If the $17 million was used to reduce debt, the associated interest cost savings would be approximately $0.5 million per year. The effect of this proposal is to utilize $17 million of the $52 million in tax room that is available to The City without restriction, and direct it to the MSI program where it can be utilized only for MSI projects subject to the associated conditions and restrictions of the program. This reduces Council's flexibility in the use of these funds.

Similarly, Administration can utilize a portion of the $52 million tax room to fund the interest cost on existing or future City tax supported debt. The interest cost made available under this scenario could be used to fund any Council approved capital infrastructure projects without the restrictions imposed by the MSI grant program. The latter approach would offer more flexibility as the available funds are unrestricted.

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Stakeholder Engagement, Research and Communication
Citizens have provided feedback on five options previously identified as possible uses for the $52 million, one of which was debt reduction.

Strategic Alignment
Debt reduction is consistent with the 2020 Sustainability Direction and associated financial goals of proactively managing debt levels, and achieving financial performance in a way that achieves and maintains public confidence in the municipal corporation. This proposal will also make funds available for capital projects expected and valued by citizens.

Social, Environmental, Economic (External)
Debt reduction can improve The City's overall financial position thereby enabling it to better support long-term social, environmental and economic goals.

Financial Capacity

Current and Future Operating Budget:
Allocating a portion of these funds to MSI interest does not have a direct impact on the operating budget.

Current and Future Capital Budget:
Allocating a portion of the available $52 million in tax room to MSI interest will make these freed up funds available for spending on other capital projects expected and valued by citizens.

Risk Assessment
Debt reduction by prepaying outstanding debt may result in penalties charged by our lender Alberta Capital Financing Authority (ACFA). These costs could be substantial and so limit the benefits obtained from this option.

Alberta Municipal Affairs (AMA) needs to approve all capital projects funded by MSI and so there is a risk that funding may not become available for the most needed projects.

REASON(S) FOR RECOMMENDATION(S):
This report is provided to further describe a debt reduction option regarding the use of a portion of the $52 million to cover MSI interest costs. The risks and limitations are included.

ATTACHMENT(S)
"Drop the debt!" Option