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Municipal Finance
Authority of BC

REPORT FROM THE CHAIR and VICE-CHAIR ON ACTIVITIES DURING THE 2019 YEAR AND FOR THE FIRST QUARTER OF 2020 UP TO MAY 15, 2020

PURPOSE

This report is intended to provide a summary of the activities of the Municipal Finance Authority of British Columbia ("MFA") during the 2019 year and the first quarter of 2020 up to May 15th, with a focus on the activities of the past six months.

GOVERNANCE

Board of Trustee Meetings

The Board of Trustees attended six meetings during the period of October 1, 2019 – May 15, 2020.

The Investment Advisory Committee, comprising all trustees, held two meetings. The purpose of these meetings is to receive reports from management and our pooled investment fund manager Phillips, Hager & North (PH&N), assess the performance of the pooled funds and authorize the creation of new funds.

Annual Business Resolutions for March 2020

On March 17, 2020, we implemented alternate arrangements to advance our annual business, as our Annual General Meeting was cancelled due to the COVID-19 crisis. We sent out a modified report package to Members asking for approval of four items by email reply.

This approach was possible for us as The Municipal Finance Authority Act, RSBC 1996 c 325, provides that a resolution that is approved in writing (including electronically) by a majority of the Members is as valid as if it were passed at a meeting of the Members properly called and constituted.

On March 25th, 2020 by 12:00pm we received a sufficient number of Member votes electronically, (34 of 39) in favor (none opposed), for all four items for which we were seeking approval.

On March 26, 2020, the Board of Trustees approved the Spring borrowing debenture to fund the loans that were authorized on March 25th under Authority Borrowing Resolution 156, 2020. MFA successfully issued a $280 million offering of new 5-year public bond to fund all the spring loan requests. With this new issue, AAA-rated MFA was proud to be the first government issuer in Canada to successfully issue a fully publicly offered security since the significant market correction earlier in March.

As part of these alternative arrangements, it was agreed that our current Trustees and Chair Malcolm Brodie will continue to serve in their positions until an election can be held in-person. At present, and as mentioned in the Board package, we anticipate the election will be held during our Semi-Annual Meeting on September 22, 2020 in Victoria in conjunction with UBCM, though we recognize that this plan may need to change as circumstances evolve.

2019 IN REVIEW AND LOOKING FORWARD

Meetings of our Members were held March 28, 2019 (AGM) and September 24, 2019 (SAGM). The Board of Trustees attended six meetings during the six-month period of October 2019 – March 2020. The Investment Advisory Committee, comprising all trustees, held two meetings. In addition, the Board of Trustees held meetings of the Investment Advisory Committee which provides oversight for our Pooled Investment Funds, and Trustees and management made presentations on behalf of the MFA at various local government conferences during the year.

From a **program perspective**, staff continued their work on updating and modernizing the Pooled Investment Fund offerings. These improvements made it simpler for clients to transact within the funds and receive expanded information regarding each fund by creating industry standard Mandate Profiles for each. The work on establishing the MFA Pooled Mortgage Fund was completed in the Fall with the first subscriptions into the fund taking place on January 28th. The establishment a Pooled Fund Advisory Committee, comprised of 10 local government investment professionals from across the Province, has been invaluable to management in ensuring that the management and reporting of existing funds together with the development of new pooled fund ideas are meeting current and future local government needs.

RESULTS

Results from Operations – Year Ending December 31, 2019

The results for the year show a combined income from operations and interest earned on the Strategic Retention Fund of $7.52 million, $1.04 million favourable to budget. Revenues were unfavourable by $165,428, which is attributed primarily to a reduced participation in pooled investment funds and a shift to pooled products with lower management fees along with less than budget investing within the sinking funds reducing the management fees on investments. Expenditures were under budget by $252,857 with savings across most line items. The Strategic Retention Fund ended the year at $83.6 million after unrealized fair market value gains and expected credit loss provisions.

Results from Operations – First Quarter 2020

Combined income from operations and interest earned on the Strategic Retention Fund for the first quarter is $1.77 million, $474,029 favourable to budget. Revenues were marginally higher than budget while expenses were favourable, which is mainly contributed to cancellations and cost delays during the year due to the COVID-19 pandemic.

Credit Rating Agency Update

On April 15th and 16th the MFA team (Malcolm Brodie, Al Richmond, Peter Urbanc, Matthew O'Rae, Shelley Hahn, Nikola Gasic, Sean Grant of MAH, and Dean Rear of Metro Vancouver) presented the annual MFA update virtually by video conference to the credit rating agencies (Moody's, Standard & Poor's (S&P), and Fitch Ratings).

The conversations were constructive and very positive overall. We are very pleased to announce that **all three rating agencies have confirmed MFA's ratings at AAA (stable)**, despite the Province of BC itself being put on "watch negative" by one of these rating agencies. Unlike a Province, that can budget and borrow to fund deficits, all agencies noted that Local Governments cannot budget for deficits. Many other factors were taken into consideration, and the agencies cited that despite the significant fiscal impacts of COVID 19, local governments in BC entered the crisis from a position of strength, are tackling expenses in a revenue challenged environment and can draw from significant reserves. They also cite MFABC's strong governance framework, prudent debt and risk management practices and forward-looking financial planning.

FINANCING

Capital Adequacy Update

In September 2019, the Board of Trustees adopted a policy and framework outlining a target for on-balance sheet risk capital, the retention of operating surplus, and the ongoing management of capital.

"Capital" for a financial institution represents the available equity on its balance sheet (assets less liabilities) that can buffer the institution against losses. It is among the most important metrics that bond investors and rating agencies look at to assess the risk of investment in a financial institution's bonds and is also a heavily regulated area for deposit-taking institutions, assessed to protect depositors. MFA is not a regulated financial institution and has therefore "self-imposed" a definition at less stringent levels than depository institutions (banks and credit unions) as it possesses a less risky loan book and other investments (our loans are to local governments and our investments are predominantly in other governmental entities) than a traditional bank.

The $84 million Strategic Retention Fund (SRF) and $111 million Debt Reserve Fund (DRF) collectively form MFA's total capital of $195 million (as at December 31, 2019). The DRF is a statutory requirement comprised of 1% retained from each loan the MFA makes to its clients that is returned to the client once the loan is repaid. The DRF therefore increases or decreases with the size of the loan book outstanding. The Strategic Retention Fund consists of retained profits from operations. Those profits are primarily earned through the spreads we earn on our lending and investment programs, and returns on surplus assets we manage.

Just like other financial institutions, the MFA has minimum capital requirements based on two traditional approaches, one based on "leverage" that MFA employs (amount of its own borrowings versus capital it holds) which is dubbed a "non-risk capital assessment", and another based on measured risks the organization takes, the "risk-based capital assessment". As at year end 2019, MFA's Capital Adequacy Model targets a capital level to meet requirements of the greater of a non-risk capital assessment ($187M) and a risk-based capital assessment ($171M) as outlined below:

	2019
NON-RISK BASED CAPITAL ASSESSMENT	
Capital Leverage Ratio:	
Total Assets	$9.4 billion
Target %	2.00%
Non-Risk Based Target Level	**$187 million**
Current %	2.08%
RISK BASED CAPITAL ASSESSMENT	
Part A - Capital Adequacy Ratio:	
Total Risk Weighted Assets	$1.7 billion
Target %	9.72%
Risk Based Target Level A (credit, operational & market risk)	**$165 million**
Current %	11.44%
Part B - Key Internal Risks:	
Risk Based Target Level B (investment return & lt debt refi risk)	**$6 million**
Combined Risk Based Target Level (Part A + Part B)	**$171 million**
Total Capital (SRF & DRF)	**$195 million**

The primary purpose of capital is to provide a cushion to absorb losses should the Authority's assets decline or its liabilities rise. Capital is used to cover material risks the organization is exposed to: credit, operational, market, liquidity, investment return, and refinancing risk. This layer of protection to debt holders helps ensure the AAA status is maintained resulting in value to Members by raising the lowest cost financing possible.

Capital remains a closely monitored aspect of the annual rating assessment. Management feels that it would be prudent to target and hold a capital buffer above our minimum requirements outlined in the Capital Adequacy Framework and Policy.

Holding a buffer will help with fluctuating requirements, in particular the capital required to be held against our loan book, which is forecasted to increase considerably over the next 3 years due to Metro Vancouver Regional District's quickly-rising requirements. 1% collected through the DRF at the outset of new loans will not keep capital at the required level to satisfy rating agencies. Unlike a commercial bank, MFA has limited levers by which to quickly increase capital through operational retained earnings if requirements quickly change.

Further pressuring capital over the next 3 years will be an increase in revenue anticipation lending to help municipalities through expected short-term cash flow shortfalls. Revenue anticipation loans are short-term loans which do not legislatively attract a 1% DRF collection. As a result, the short-term lending rate charged on these loans has been increased to help compensate for the capital requirements that the organization needs to hold given the risk associated with these loans. This action has been viewed favorably by the rating agencies.

Given the anticipated increased activity in our short- and long-term loan programs, it remains prudent for the Authority to build and hold an appropriate capital buffer over and above our minimum capital levels, given the aforementioned limited ability to quickly respond to shocks in required capital levels. Over the coming months and years, we will be discussing appropriate capital levels, in line with our ever-evolving operational footprint. This discussion will inform how much of our operational earnings need to be maintained on MFA's balance sheet versus returned to our Member-owners.

LENDING

Long-term Lending

On March 26th, 2020 at the height of the COVID-19 crisis, we reopened our 2.65% October 2025 debenture for $280 million to fund new loan requests at a re-offer yield of 1.855%. The issue was 2x oversubscribed and well diversified between 17 investors. This was the first syndicated, widely distributed public sector transaction since the crisis began. Every other deal to date by other issuers (including large entities such as the Province of Ontario and Province of British Columbia) had been privately placed on behalf of the syndicate. Reopening of a 5-year bond was chosen in place of the typical 10-year bond given market volatility, investor sentiment and interest in shorter-dated securities.

Short-term Lending

The Commercial Paper Program continues to provide low-cost short-term and equipment financing to our clients. Our short-term lending rate is currently 1.54%. On May 1st, we increased our margin on the short-term lending rate by 35 basis points to reflect increased capital requirements and costs associated with expected Revenue Anticipation lending.

We continue to increase our commercial paper outstanding and as of May 12th (the last date we were in the market) we had $610 million issued. We will continue to incrementally raise funds as required to bring our outstanding balance to $700 million.

As at the end of April, there were 392 short-term loans outstanding with an aggregate outstanding balance of $196.5 million.

We have been working towards having all the necessary authorizations in place in to increase our Commercial Paper program from its existing authorization of $700 million to $1 billion. This extra capacity will allow us to cover any Revenue Anticipation loans our clients need to help them manage potential taxation collection delays.

POOLED INVESTMENT FUNDS

As at	**March 31, 2020**	**March 31, 2019**	**Change**		**1 Year Returns at March 31, 2020**	
	$ millions				Funds	Benchmark
Bond	555	545	10		3.20 %	3.00 %
Intermediate	259	218	41		2.05 %	2.78 %
Money Market	1,148	1,043	105		1.79 %	1.60 %
Mortgage Fund	79	-	79		N/A	N/A
Pooled High Interest Savings Account *	711	636	75		**	N/A
AUM	**2,752**	**2,442**	**310**			

** Rates as of March 31st on CIBC and NBC PHISA's were 0.90% and 0.82%, respectively

Intermediate Fund Update – (Now: Government Focused Ultra-short Bond Fund)
At the April 21st Meeting of the Board of Trustees, it was approved to "tilt" the current Intermediate Fund to a Government Focused Ultra-short Bond Fund (GFUS BF). MFA staff has communicated the expected changes to all unit holders in the Intermediate Fund by email, on our website and a direct message to the client interface. In addition, the GFUS BF will be a fossil fuel free option for Local Governments to complement the "Fossil Fuel Free Short-term Bond Fund" and will remain a staple to the MFA's suite of Pooled Investment products.

Fossil Fuel Free Short-term Bond Fund
On May 4th, we opened the Fossil Fuel Free Short-term Bond Fund (FFF STBF) and received inaugural subscriptions totalling $60 million. The fund employs a 'fossil fuel free' screen which will exclude securities of companies directly involved in the extraction, processing and transportation of coal, oil or natural gas. Although we had several local governments show interest during the run up to the launch of the fund ($125 million in interest), during the uncertainty of these times, many are opting to keep their investments within a shorter duration. With the possibility of delayed revenues for local governments, many are waiting before investing. As an alternative, those local governments interested in shorter term more liquid investments can now access the newly created Government Focused Ultra-short Bond Fund as a fossil fuel free option.

Mortgage Fund
On January 28th, we called 75% of the Phase 1 requests totaling $104 million (8 local governments). Currently we have the remaining 25% ($25 mm) from Phase 1 still in the queue and have started a Phase 2 intake that currently has $68 million (4 local governments). Given

the market volatility COVID 19 has caused, PH&N are taking an active approach to monitoring and protecting existing investments and will likely not be taking further intakes for several months.

2020 BUSINESS PLAN

In 2019, we made major progress towards our vision of a future-focussed MFA, including adding a new Pooled Fund Advisory Committee, beginning a major technology update, and re-imagining our brand. Over the last 5 years, the MFA has been on a transformational journey as we modernize and add even greater value for our clients.

The 2020 business plan is driven by our 5 key strategic focus areas of Stakeholder Engagement, Resilience & Capacity, Professional Financial Management, Program Development & Improvement, and Technology Support & Security.

Primary themes for 2020:
- Increasing education and sponsorship support as our third pillar of services we offer;
- Building resilience by strategically adding additional team members while increasing and formalizing cross-training;
- Implementing new tools and processes in our financial management systems to reduce risk and manual effort;
- Launching new investment products to meet evolving client needs and market changes;
- Updating our technology systems and increasing cybersecurity through cloud-based solutions.

Technology Support and Security
The information technology and systems work completed over the last 5 years allowed the entire MFA team to move quickly and easily to a work from home plan when we determined this was prudent. Although this move did cause some delays relating to contractor availability during the initial Covid-19 pandemic declaration, our work to enhance and strengthen our systems, practices, and architecture are making good progress. We are building in enhanced cybersecurity elements throughout this process and will re-evaluate our progress against the "Defensible Cybersecurity for Public Sector Organizations" standard early in Q3.

Sponsorship and Education Support
The MFA is proud to be a major, non-commercial supporter of BC's local government elected officials and staff events and conferences each year. We primarily support financial education, in direct line with our own mandate. We also support training in management, leadership, and cybersecurity, which has become a major operational and financial issue in the Local Government sector globally. The total education and sponsorship contribution for 2019 was $167,500, while our budget for 2020 is $218,000.

In 2019, the MFA entered into a Strategic Education Alliance (SEA) with the Government Finance Officers Association of BC (GFOABC). This SEA will ensure we consistently contribute to the delivery of comprehensive course offerings to Local Government team members in the same way we do with the Local Government Leadership Academy. The Government Finance Officers Association of BC has the most direct connection to our primary users.

The Covid-19 Global Pandemic has had an impact on the education programs, conferences, and events that the MFA supports. Funding was provided early in the year to several cancelled/postponed events. We have asked the majority to hold the funds to apply to 2021 events to avoid the struggle for these organizations to refund the monies and for our team to receive and deposit cheques. The GFOABC conference will still proceed in a virtual format and our team members will both attend and support the MFA by being available for client questions and interaction during the virtual 'tradeshow' presentations. UBCM has just announced the potential to move to a virtual format but they are waiting to see how Covid-19 restrictions play out closer to the event. When we know what UBCM plans to do, we can make plans for our Semi-Annual Meeting usually held in conjunction with this event. The Sponsorship and Education budget will not be fully spent in 2020.

<u>SUMMARY / CONCLUSION</u>

Additional information respecting the MFA Semi-Annual Meeting of members that is scheduled be held on the afternoon of Tuesday, September 22, 2020 will be forthcoming very soon.

The 2021 Annual General Meeting and Financial Forum event is currently set to take place in Victoria on March 24 and 25, 2021.

Submitted by:

Malcolm Brodie	Al Richmond
Chair	Vice-Chair