City of Toronto Social Debenture Program

Date: May 6, 2020  
To: Debenture Committee  
From: Chief Financial Officer and Treasurer  
Wards: All

SUMMARY

This report provides the Debenture Committee with information on the City's new Social Debenture Program. This important and innovative type of financing would allow the City of Toronto to maintain its leadership role in the area of Sustainable Finance by being the first Canadian municipal issuer of Social Debentures. Moreover, the Social Debenture Program aligns with the City’s vision and strategic priorities to promote positive social outcomes. In addition, the City may achieve slightly lower borrowing costs under this program as it responds to global investor demand.

The planned Social Debenture issuance in 2020 is within the Council approved multi-year debenture and temporary borrowing limit for 2019-2022. The estimated total Social Debenture issuance in 2020 is up to $100 million.

City of Toronto’s Social Debentures share the same financial and legal characteristics as the City’s general obligation debentures issued in the past which are backed by the credit and taxing power of the City. The differentiating feature of Social Debentures is the limited and targeted use of proceeds. Under the Social Debenture Program, net proceeds from debentures will be used to fund Council approved capital projects that align with the Council adopted plans, policies, and strategies that support affordable housing, affordable basic infrastructure, access to essential services, and socioeconomic advancement and empowerment.

RECOMMENDATIONS

The Chief Financial Officer and Treasurer recommends that:

1. The information provided by this report be received by the Debenture Committee.
FINANCIAL IMPACT

It is anticipated that the City's Social Debentures will have the same, or slightly lower, borrowing costs than the City's conventional debentures due to higher investor demand. Payment of principal and interest required by the Social Debentures are included in the debt service cost estimates provided for in the 2020 Council approved operating budget.

DECISION HISTORY

City Council approved the issuance of debentures for the purposes of long-term financing of capital works in an annual amount not to exceed $1.0 billion per year from 2019 to 2022. This decision also authorizes the Mayor and the Chief Financial Officer and Treasurer ("CFO") to enter into agreements in 2020 for the issue and sale of debentures. The terms of any such agreement to issue debentures must be reported by the CFO to the Debenture Committee for approval.

http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.EX1.8

COMMENTS

Sustainable Finance and the City of Toronto

The City of Toronto has previously shown leadership in the area of Sustainable Finance with its launch of the Green Debenture Program in 2018. Investors with focus on Environmental, Social, and Governance (ESG) concerns have overwhelming supported the City's two initial green bond issues that include capital projects with positive environmental impact. Many of these same investors are now looking to make an impact in other key areas that relate to community and social services that address inequality and provide opportunities for disadvantaged and vulnerable groups.

Studies have shown that long-run sustainable returns are generated by governments and companies that are focused on environmental, social, and governance factors. Investors want to ensure their investment dollars are used in a way to affect positive change in these areas not only because it is the right thing to do but will also generate positive returns over the long-run. Most often investors are willing to pay a premium to align with these high quality organizations that share these same values and can demonstrate their commitment through the impact reporting feature of these Green, Social and Sustainability Bond Programs.

By moving forward with this Social Debenture Program, the City will be the first municipality in Canada to launch this important and innovative form of debt financing and continue its leadership in the area of Sustainable Finance. On a global basis, the
City would be joining a group of its peers that have used this approach which includes (but not limited to): Los Angeles, Madrid, Barcelona, and Reykjavik.

More importantly, this new approach focuses on outcomes that align with many of the City's Strategic Priorities namely:

- Maintain and create affordable housing;
- Keep Toronto moving;
- Investing in people and neighbourhoods; and
- Tackle climate change and build resilience

In addition, the Social Debenture Program advances the City of Toronto's vision of a caring and friendly city that invests in quality of life.

**History and Market Development**

Compared to Green Bonds, Social Debentures (also known as "Social Bonds") have a relatively short history but have witnessed rapid growth since the launch of the Social Bond Principles in 2017, and are becoming the next frontier in Socially Responsible Investment. More specifically, Social Bonds are fixed-income financial instruments that have the same characteristics as traditional debentures however are used to finance projects with identified positive social objectives. Social Bonds can be issued by public and private organizations, and are traded in the secondary public bond market after issuance.

While Social Bonds are relatively new in Canada, they have existed in other countries (especially in Europe) for several years. In addition to Green and Social Bonds, there are also Sustainability Bonds which can be used to finance a combination of both Green and Social projects.

On a global basis, the value of debt issuance for all Green, Social, and Sustainability bonds was approximately $323 billion in 2019, increasing 52% from the previous year. Despite 47% growth in Green Bond issuances in 2019 (to $258 billion), debt issuers have begun addressing social initiatives by issuing Social Bonds and Sustainability Bonds. Social and Sustainability Bond issuance more than doubled in 2019 to $65 billion.

Several investment banks in the City's debt syndicate have advised that Canadian investors prefer separate debt issues of either Green Bonds or Social Bonds rather than a mixture of both (Sustainability Bonds). This was based on feedback they received from several North American investor panels and prominent institutional investors in the Canadian Green, Social, and Sustainability debt market.

It is expected that corporations and municipalities will require significant funding to mitigate the impact of COVID-19. As a result, a steep increase in Social and Sustainability bond issuance is anticipated in the coming months.
Types of Social Projects

The City's Social Debenture Program seeks to promote positive socioeconomic outcomes for target populations. The City has developed a Social Debenture Framework in accordance with International Capital Market Association's (ICMA) 2018 Social Bond Principles. The ICMA's Social Bond Principles are widely considered to be an industry best practice. According to the City's Social Debenture Framework, the following types of projects are considered eligible capital projects for financing from Social Debenture proceeds:

- Social and Affordable Housing;
- Affordable basic infrastructure (e.g. access to clean drinking water, sewage and sanitation systems, and transit);
- Access to essential services (e.g. long-term care; senior services; and emergency shelters); and
- Socioeconomic advancement and empowerment (e.g. public libraries, and community hubs).

Issuance Process Overview

Prior to issuing a Social Debenture, the City is required to complete the following steps:

1. **Develop a Social Debenture Framework in line with industry best practices (i.e. Social Bond Principles).**

   The Capital Markets Division (CMD) has developed a Social Debenture Framework in consultation with Sustainalytics. The framework governs the use and management of proceeds, project evaluation and selection process, ongoing reporting requirements, and compliance review. Please refer to Attachment 1 for the City’s Social Debenture Framework.

2. **Select eligible capital projects from council approved budgets.**

   Selection of eligible capital projects will be the responsibility of the Capital Markets Division in consultation with internal and external expert stakeholders, which may include the combined effort of Division Heads (or designates) in Community and Social Services as well as Infrastructure and Development Services that are accountable for the Social Projects, and Legal Services Divisions and other City Divisions, Agencies and Corporations, as required.

3. **Obtain independent second-party opinion on the City's Social Debenture Framework.**

   Sustainalytics, a leading Environment, Social, and Governance (ESG) second-party opinion provider, was engaged to review the Social Debenture Framework and provide an opinion on the City's social credentials and the framework's alignment with the Social Bond Principles, as administered by the International Capital Market Association (ICMA).
Sustainalytics released its opinion on March 18, 2020. Sustainalytics is of the opinion that the City of Toronto Social Debenture Framework "is credible and impactful". In addition, Sustainalytics is "confident that City of Toronto is well-positioned to issue social debentures and that the Social Debenture Framework is robust, transparent, and in alignment with the core components of the Social Bond Principles 2018". For the full Sustainalytics' second-party opinion, please refer to Attachment 2.

4. Market the new Social Debenture Program to potential and existing global investors of City’s debentures.

Planned investor relations initiatives include presentations at various major government finance, Social Bond, and Sustainability Investing themed investor conferences as well as various one-on-one investor meetings and conference calls (or webcasts).

5. Issue the Social Debenture.

This step is largely in line with the traditional debenture issuances. The City will follow its current debt issuance procedure as prescribed in the City of Toronto's Financing of Capital Works Policy and Goals, subject to a limitation on the use of proceeds as set out in the Social Debenture Framework. The Mayor or the Mayor's Alternate and the CFO are authorized to issue debt within the annual limit approved by City Council.


The Accounting Services Division will be responsible for keeping track of the funding status and funding allocation to each project and proceeds will be directly applied to projects at the time of issuance. Where substantial completion has not been met on a social project, funds will be invested and held in a City account.


Transparency is a key requirement of a successful Social Debenture Program. After the Social Debenture is issued, annual newsletters will be published on a dedicated Social Debenture Program webpage within the City of Toronto website. Newsletters will provide updates on the use of proceeds, project status, and social impact.

Benefits

The Social Debenture Program demonstrates the City's commitment to positive social objectives by financing the City's eligible capital projects in various social initiatives such as housing, and projects related to the HousingTO Action Plan, and marks the City as the first municipality in Canada to issue a Social Debenture.

Moreover, the Social Debenture Program will maintain the City's competitiveness in the primary debenture market by gaining access to capital from socially responsible funds and investors globally. This is particularly opportune since these markets have grown significantly in recent years.
Finally, there is potential saving in borrowing costs. Past issuances of Green, Social, and Sustainability bonds worldwide have been well received by the market and have resulted in favourable pricing versus conventional bonds. This could be credited to the heightened awareness and demand for sustainability supporting investments worldwide.

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SIGNATURE

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ATTACHMENTS

Attachment 1 – City of Toronto Social Debenture Framework
Attachment 2 – Second-Party Opinion by Sustainalytics