Proposed amendments to FNFMA Section 77

1) Basic proposal

To clarify that a First Nation may only cease to be a borrowing member with the consent of all other borrowing members using same revenue stream (i.e. property tax revenues group or other revenues group).

2) Justification/Rationale

The intention is to preserve the "firewall" that currently exists between FNFA's borrowing members – created by the *FNFMA* (property revenue supported loans) and the *Financing Secured by Other Revenues Regulations* (other revenues supported loans). Under the *FNFMA* and the other revenues regulations there can be no cross-liability between the groups of borrowing members, such that a borrowing member of the other revenues pool has no liability or authority in relation to the activities of borrowing members of the ll property tax revenue pool, and vice versa. The shared responsibilities of borrowing members are tied to their respective borrowing pools; accordingly, there is no rationale for requiring consent from borrowing members of the other borrowing pool. This proposed amendment is necessary in order to be consistent with that policy approach.

3) Example of Practical Application

The separation between borrowing members who borrow using property tax revenues and those that borrow using other revenues ties into rating agency analysts ratio analysis for property tax revenue loans and for other revenues supported loans. The FNFA has two credit ratings from two separate credit rating agencies. In both cases these ratings are based on rating agency analysts understanding that there is a clear separation is how the FNFA operates between borrowing members that borrow using property tax revenues and borrowing members using other revenues, This amendment will legally support and strengthen this approach. Of great importance in this separation is the creation of two separate Debt Reserve Funds that are maintained for each type of borrowing member (i.e., 'property tax revenue' and 'other revenue'), and no cross-liability exists (i.e., an obligation to replenish the Debt Reserve Fund only arises where a borrowing member that defaults uses the same revenue stream –property tax revenues, or other revenues). This separation with respect to ceasing to be a borrowing member will be consistent with the policy approach taken with respect to the DRFs. It will ensure that only borrowing members that use either property tax revenues or other revenues can determine if a borrowing member in that group is in or out of the FNFA.

Proposed Amendment to Section 57

1) Basic proposal

To include in the definition of "property tax revenues "in section 57 of the FNFMA reference to "payments received from a government or other entity in lieu of monies raised under a property taxation law under paragraph 5 (1) (a)".This amendment will allow the FNFA to provided financing to a borrowing members utilizing such payments. This proposed amendment is submitted jointly by the FNFA and the FNTC.

2) Justification/Rationale

In some circumstances a First Nation cannot collect property taxes from a government or other entity on reserve lands. In such cases there are often agreements with that government or entity that they will pay the First nation an amount "in lieu of taxes". The FNFMA as presently written does not allow the First Nation to utilize the FNFA for financing relying on such payments. The proposed amendment will allow for such payments to be used independently, or together with, property tax revenues for financing through the FNFA. All the provisions of the FNFMA dealing with financing secured by property tax revenues will apply. The recognition that these are payments "in lieu of taxes" supports the policy approach that First Nations should be allowed to use these revenues for financing in the same manner as property tax revenues. This amendment will allow this and increase the access to long term capital financing by First Nations who are collecting payments in lieu of taxes.

3) Example of Practical Application

N/A

Proposed Amendment to Section 78

1) Basic proposal

To clarify the timing of the priority of the FNFA over all other creditors of a First Nation that is insolvent. The priority will operate from the date the First Nation borrowing member has received financing from the FNFA.

2) Justification/Rationale

The priority position of the FNFA under s. 78 over other creditors where a first nation is insolvent is a significant element of the FNFA financing model accepted by the credit rating agencies and banking syndicate supporting the issuance of FNFA securities. It is necessary to have the same rules for financing secured by property tax revenues and financing secured by other revenues and for those rules to be clear as to the timing and extent of the priority. The proposed amendment accomplishes this.

3) Example of Practical Application

The FNFA priority is extremely important to the FNFA credit rating and must be clear and consistent for all revenue sources used for loan repayment. Under the current provision of the FNFMA and the ORR this is not the case and could lead to confusion in the event of a borrowing member becoming insolvent, however unlikely.

FNFA's borrowing members have obligations to pay debt service payments to the FNFA in amounts and on dates as outlined in promissory notes entered into with respect of specific FNFA borrowings. Failure to pay these amounts in full and on-time would constitute a default by that borrowing member under the *FNFMA* rules. In addition to the mechanism under the *FNFMA* that require intervention by the FMB in the event of default, the FNFA would be obligated to enter discussions with those rating agencies that have rated the FNFA as to FNFA's 'game plan' to recover the defaulted payment(s). If FNFA is unable to show priority, and to produce a viable strategy towards loan service recovery it is possible that: (i) the remaining members themselves must pay the defaulted balance (impacting their cash flows and budgets negatively), and/or (ii) the rating agencies will downgrade FNFA's credit ratings – causing future debenture issuance to become more difficult and more costly to its borrowing members.

It is not clear in the *FNFMA* when the FNFA's priority commences under s78 commences which could result in confusion at a later date should the borrowing member become insolvent. It is not clear if priority begins when: i) a borrowing law is made; ii) when the First Nations is accepted by the FNFA to become a borrowing member; iii) when a securities issuing resolution is passed by council, or; iv) when the borrowing member actually receives financing and whether this is for each time and for specific financing or just the first time. Practically this could create confusion and was an issue that was raised during the lead up

to the inaugural FNFA debenture. Practically it is felt that the best time for the priority to start is after the borrowing member receives financing for the first time and provide the priority for the full amount authorized by the borrowing member in its borrowing law.

Proposed Amendments to Paragraph 79(b)

1) Basic proposal

To provide that FNFA will not make a loan using property tax revenues as security unless it is satisfied that there has been compliance with the Act.

2) Justification/Rationale

The proposed amendment removes the reference to "in priority to other creditors", as this wording created some uncertainty and imposed unreasonable restrictions on FNFA and on borrowing members wishing to securitize property tax revenues. The proposed amendment instead requires compliance with relevant provisions of the *FNFMA.* Sections 11 (2) and 11 (3) of the FNFMA provide sufficient protection to ensure repayment to the FNFA in a timely manner and which practically ensure that the FNFA will be paid in priority to other creditors without the legal requirement for ensuring that priority. In addition subsection 11 (1) of the Act provides that a borrowing member shall not repeal a property taxation law.

3) Example of Practical Application

The FNFA Board must approve unanimously any new loan requests from a borrowing member. This review and vote is based upon adequacy of revenue stream (amount and duration), FMB Certification processes, FNTC approvals (where appropriate), and other safeguards under the *FNFMA*.

It is not possible for the FNFA Board to undertake a comprehensive collateral search each month on all assets of a borrowing member to ensure that the FNFA is being paid "in priority to other creditors". Certain operational functions by a borrowing Member (e.g. such as leasing a photocopier or computers, etc.) will result in the financing company registering collateral title to secure its asset. This registration, while in no way impacting the borrowing members ability to service its loan(s) to the FNFA, could however cause the FNFA loan to be off-side with the *FNFMA* requirements. It also could hand-tie the borrowing member from a normal course of operations with supply companies.

The impact of this change will have no practical implication for the credit rating of the FNFA. Rating agencies rate the FNFA based upon its processes and its safeguards for investors. Non-material priorities by other companies are a normal operational process not only for First Nations but also local governments, and will not impair FNFA's credit ratings.

Proposed Amendment to Section 80

1) Basic proposal

To clarify the intent of section 80 to limit a borrowing member who has secured financing from the FNFA using property tax revenues from securing long term financing elsewhere.

2) Justification/Rationale

The restriction at section 80 should only be placed on borrowing members who have previously obtained from FNFA long-term financing secured by property tax revenues. There are no financial obligations to the FNFA or under the FNFMA on a borrowing member until they are in receipt of financing from the FNFA and accordingly no rationale for limiting their financial flexibility before they have borrowed from the FNFA. The current wording is unnecessarily restrictive and may be a barrier to First Nations who would otherwise be interested in being scheduled to the *FNFMA*.

3) Example of Practical Application

This situation arises where a First Nation has been certified by FMB, has been accepted as a borrowing member by the FNFA but has not yet obtained any financing from FNFA. The First Nation has the opportunity, now, to obtain a loan from a bank, at a normal bank loan rate and collateral process, using its property tax revenues as security for the loan. This loan is of a timely nature so the project can commence, and even though a FNFA loan would be of lower interest rate and longer repayment duration, thereby improving Member cash flows and budgets, they need the monies now. However, due to the Scheduling requirement and FMB Certification timeline it will take several months once the First nation is a borrowing member to obtain financing from the FNFA. As presently drafted, section 80 as currently exists would prevent the First Nation from taking out a loan from the bank in that interim period , thereby impacting the project's opportunity. The FNFMA should not limit this flexibility particularly where there is the intention by the First Nation as a result of becoming a borrowing member to borrow from the FNFA.

Note, that FNFA will not lend to a First Nation where it is in second priority to a bank regarding the revenue stream supporting the loan. However, the FNFA does – when a borrowing member requests – supply loan monies to allow the borrowing member to repay the higher rate bank loan, and thereby improve cash flow and budget performance. Commencement of the project is in the best interest of the First Nation and the FNFA, even when it is started with a loan from a bank.

Proposed Amendments to FNFMA Subsection 82(3)

1) Basic proposal

To allow FNFA to invest sinking fund moneys in its own securities as well as those of provincial finance authorities such as the Municipal Finance Authority of BC ("MFABC").

2) Justification/Rationale

Rating agencies and investors analyze the FNFA's creditworthiness based upon certain financial ratios. One ratio looks at debt outstanding. A common practice amongst Canada, the provinces, and BCMFA (a pooled borrower similar to FNFA) is to re-purchase their own debentures, thereby reducing the debt outstanding, and thereby improving balance sheet ratios – leading to improves rating agency analysis. The MFABC, under section 14 (3)(c) of the BC *Municipal Finance Authority Act* has currently a few hundred million dollars of its own debentures retired in this manner.

The MFABC, which is deemed a municipality (for certain purposes) under the BC *Municipal Finance Authority Act* has the following investment parameters:

> (3) Money at the credit of the sinking fund that cannot be immediately applied toward paying the debt or discharging the obligation because no part of the debt or obligation is yet payable may be invested or reinvested by the trustees in any of the following:
>
> (a) securities of the government of Canada or a province of Canada;
>
> (b) securities, the principal and interest of which is guaranteed by the government of Canada or a province of Canada;
>
> (c) securities of a municipality or regional district in British Columbia, or of a local, municipal or regional government in another province of Canada, maturing not later than the securities, the repayment for which the sinking fund was created;
>
> (d) investments guaranteed by a chartered bank;
>
> (e) deposits in a savings institution, or non-equity or membership shares of a credit union.

3) Example of Practical Application

Under the FNFMA t, the FNFA operates a sinking fund for each of its debentures (a sinking fund is the investing of principal monies repaid to the FNFA by its members. These

investments build up to retire the very debenture that financed these members' loan requests). The repurchasing of its own debenture(s) makes a perfect hedge to retiring the same debt issue that raised the financing.

Proposed Amendment to Section 84 (1)

1) Basic proposal

To confirm that there are separate Debt Reserve Funds ("DRFs") and replenishment mechanisms for property tax borrowing and for other revenues borrowing.

2) Justification/Rationale

Borrowing from FNFA using property tax revenues and other revenues are completely separate. There is no cross liability for borrowing members in each borrowing group to replenish the other Debt Reserve Fund in the event of a default by a borrowing member in the other group. Section 84 should be amended to confirm this.

In addition there needs to be a determination as to whether amendments to the Act in s. 84 (2) (4) and (5) and to the *Debt Reserve Fund Replenishment Regulation* would remove the need for s. 19, 22 and 23 of the ORR which could then be repealed.

3) Example of Practical Application

Current FNFA financial software is designed to accommodate this separation of DRF's. As well, each rating agency analyses separately property tax supported loan ratios and other revenues supported loan ratios.

Proposal to amend FNFMA Subsection 84(2)

1) Basic proposal

To allow flexibility in the amount of cash contributions to the Debt Reserve Fund ("DRF") and to ensure the same treatment for both the DRF for property tax revenues and the DRF for other revenues. To parallel other co-operative borrowing pools that have this flexibility.

2) Justification/Rationale

In order to respond to market conditions to maximize FNFA's benefits to its borrowing members, the FNFA's Board must have control over setting DRF cash withholding rules. A process that takes weeks or months to modify the DRF cash rule will possibly miss market opportunities. When the *FNFMA* was initially drafted it was felt that there should be a 5% contribution to the DRF as this was what the rating agencies at the time required. It is important to understand that the relationship between the rating agencies (Moody's/S&P) and the FNFA and contractual and the requirements or expectations of the rating agencies can change notwithstanding the legislation..

The rating agencies analysts apply ratio analysis to both FNFA's balance sheet and income statements. One key ratio analyzes the debt aggregate of the FNFA borrowing members to their annual revenues that can support such debt. A reduction, sometime in the future, from a 5% cash withholding to less than 5% will have an immediate positive impact on FNFA's aggregate borrowing member ratios. A positive ratio impact would help push FNFA into a higher credit rating, and thereby reduce its interest rate spread cost over Canada's.

In time, a reduction from 5% cash withheld to 1% would save FNFA's borrowing members $4,000,000 in debt (1% times $100 million debenture instead of 5%), and also the annual corresponding interest savings. This $4,000,000 for each debenture can translate into approximately 25 to 27 new houses (est. at $150,000 per house).

It should be noted that no reduction from the 5% cash withheld level can occur prior to both rating agencies achieving comfort that the DRF had reached a sufficient cash level to allow such a change to occur. However, the analysts do not require the amount to be set in law at 5% and there is a benefit for greater flexibility as set our above. Section 74 (c) of the *FNFMA* mandates that FNFA achieve the best possible credit terms for its borrowing members, and therefore the FNFA Board would ensure the rating agencies support and any change from the current practice, namely any reduction in the amount withheld below 5%. A minimum amount of 1 % has been included in the proposed amendment.

All safeguards such as DRF Replenishment rules, revenue intercept mechanisms, debt coverage ratios (e.g., only a certain percentage of revenues are allowed for debt service), annual rating agency reviews, unanimous Board approvals for new Members loan requests, etc., remain in place regardless of DRF cash rate.

3) Example of Practical Application

It should be noted that the approach taken in this amendment would be consistent with the practical application found in the BC *Municipal Finance Authority Act.* The text of the applicable sections is as follows:

Debt reserve fund

15 (1) The authority must establish a debt reserve fund in accordance with this section.

(2) Each regional district sharing in the proceeds of a security issue of the authority must pay over to the authority to repay the obligations to the authority under that security issue an amount equal to

(a) 1/2 the average annual installment of principal and interest in respect of its own borrowing under section 825 *[security issuing bylaws]* of the *Local Government Act*, and

(b) 1/2 the average annual installment of principal and interest as set out in the agreements entered into with, or securities issued to, the regional district by member municipalities with respect to financing under section 824 of the *Local Government Act*.

(3) Despite this Act, the amount required to be paid by each regional district under subsection (2) may be paid to the authority on the following basis:

(a) each regional district must, on receiving the net proceeds of the borrowing, pay an amount equal to 1% of the total principal amount borrowed;

(b) each regional district must, without further requirement of bylaw or resolution, secure the balance of its liability to the debt reserve fund under this section by issuing to the authority a non-interest bearing demand note for the balance, bearing the signature of the chair and countersigned by the regional district financial officer or another officer designated by the regional board;

Proposed Amendment to Subsection 84(5)

1) Basic proposal

To confirm that only borrowing members who have received financing are responsible to contribute to and replenish the specific Debt Reserve Fund ("DRF") established for the revenues supporting the financing (ie other revenues or property tax revenues) and to confirm that there is no cross responsibility to contribute to or replenish the other DRF.

2) Justification/Rational

As presently drafted, subsection 84(5) could be interpreted to require all First Nations that are "borrowing members" to contribute to DRFs, regardless of whether they have obtained financing from FNFA. The amendment is required to clarify the intent of the subsection. This is important for administrative fairness. It is also important to ensure that First Nations are not dissuaded from getting scheduled to the *FNFMA* or from becoming borrowing members.

3) Example of Practical Application

FNFA's two credit ratings look at both the revenue streams supporting the repayment of the loans, plus the cash (DRF + CEF monies) that FNFA has on-hand to ensure full and timely debenture service. Rating agency analysis applies only the "Other Revenues DRF" to the other revenues supported loan rations, and "Property Tax Revenues DRF" to the property tax supported loan ratios. This distinction regarding replenishment maintains the firewall between property tax supported loans and other revenues supported loans.

FNFA's financing software tracks both type of borrower separately, and firewalls both DRF's and their replenishment calculation formulae.

Proposed Amendments to Subsection 84(6)

1) Basic proposal

To clarify that FNFA will not reimburse a borrowing member for their contribution to the Debt Reserve Fund ("DRF") where that borrowing member has already been reimbursed by the defaulting First Nation.

2) Justification/Rationale

The amendment is needed will ensure that borrowing members who have contributed to the replenishment of a DRF will not receive a "double payment " for this amount in circumstances where they have been previously reimbursed for their replenishment amount through the defaulting borrowing member repaying the FNFA for the default and the FNFA has forwarded a proportionate rep[payment to the borrowing member replenishing the DRF. The separation between the DRF established for financing secured by other revenues and the DRF established for financing secured by property tax revenues is maintained in this amendment.

3) Example of Practical Application

FNFA's software is copied from the software used by BC *Municipal Finance Authority Act* and its debt reserve fund sections of the FNFMA also parallel the practices of the BC *Municipal Finance Authority Act* . This amendment would create the mathematical accuracy regarding repayment to any member that helped to replenish the debt reserve fund. This amendment removes a potential of double repayment to any member, which was not the intention of the FNFMA.

Proposal for amendment to Section 85

1) Basic proposal

To establish the mechanism for repayment to the Credit Enhancement Fund ("CEF") following a payment from the CEF to replenish the Debt Reserve Fund ("DRF").

2) Justification/Rationale

Section 20 of the ORR has a mechanism for repayment to the CEF where a payment has been made from the CEF to the other revenues DRF. The proposed amendment is required to establish a comparable process for repayment to the CEF where a payment has been made from the CEF to the property tax revenues DRF.

3) Example of Practical Application

Rating agency analysis when, if ever, a problem develops by a FNFA member to repay in full its loan service will focus on the flowchart of cash flows, and the timelines within this flowchart/game plan. The FNMA mandates that FNFA repay the CEF any monies it has pulled from the CEF within 18 months; this amendment will complete the needed flowchart approach to accomplish this.