STAFF REPORT ACTION REQUIRED

Potential Monetization of City Assets

Date:	June 2, 2010
To:	Executive Committee
From:	City Manager Deputy City Manager and Chief Financial Officer
Wards:	All
Reference Number:	P:\2010\Internal Services\Cf\Ec10030cf (AFS #12067)

SUMMARY

The City of Toronto will be faced with significant fiscal pressures in the coming years. One strategy to help deal with fiscal constraints is to attempt to increase the returns on City held assets, as can sometimes be achieved by converting City investments in assets into cash where the assets may not be producing optimal financial or public policy benefits.

The purpose of this report is to provide preliminary information to Council regarding the potential for monetization of the City's corporate investment interests in Toronto Hydro Corporation, Enwave Energy Corporation and the Toronto Parking Authority. Monetization of these assets could allow for the City to realize a portion of the current market value, and reinvest the proceeds in higher order City public policy priorities, including debt reduction.

Notwithstanding the potential monetization of City assets, it must be emphasized that Council needs to consider the public policy ramifications of the sale of City assets. In addition, Council is aware that potential monetization of City assets is not the long term solution to financial sustainability, but only one possible action in minimizing long term debt for the City of Toronto.

RECOMMENDATIONS

The City Manager and Deputy City Manager & Chief Financial Officer make the following recommendation:

1. Council authorize the City Manager and the Deputy City Manager & Chief Financial Officer, in consultation with the City Solicitor to request the Province to amend the *Electricity Act,* 1998 or the regulations under that Act, to eliminate the City's obligation to pay any departure or transfer taxes applicable to the monetization of Toronto Hydro Corporation.

Financial Impact
There are no financial impacts resulting from this report.

ISSUE BACKGROUND
Budget Committee received a staff presentation entitled "Long Term Fiscal Plan Update" on March 12, 2010, indicating that a report to further examine monetization options would be submitted to Executive Committee in May or June.

The City has ownership interests in three corporate entities that have significant value generation capacity and may therefore be highly marketable – the Toronto Parking Authority (TPA), Toronto Hydro Corporation (THC), and Enwave.

The TPA generates significant revenues for the City each year as it pursues its mandate to provide paid parking accessibility through the City's commercial districts. The City's two energy corporations, THC and Enwave, have delivered on key City policy objectives such as energy reliability and air quality, while generating significant dividends and/or equity value growth.

It is important to periodically review the public policy and financial benefits of retaining the current investments versus potential divesture or monetization options.

Potential Benefits from One Time Proceeds of Asset Monetization
The City's fiscal challenges relate to expenditure growth outpacing revenue growth, despite spending restraint. In order to achieve a sustainable match of expenditures and revenues, the City needs to increase revenues more rapidly than traditional growth in property tax revenues. These challenges were outlined in staff presentations to the March 12, 2010 Budget Committee entitled "Long Term Fiscal Plan Update", and to Council during the 2010 budget process.

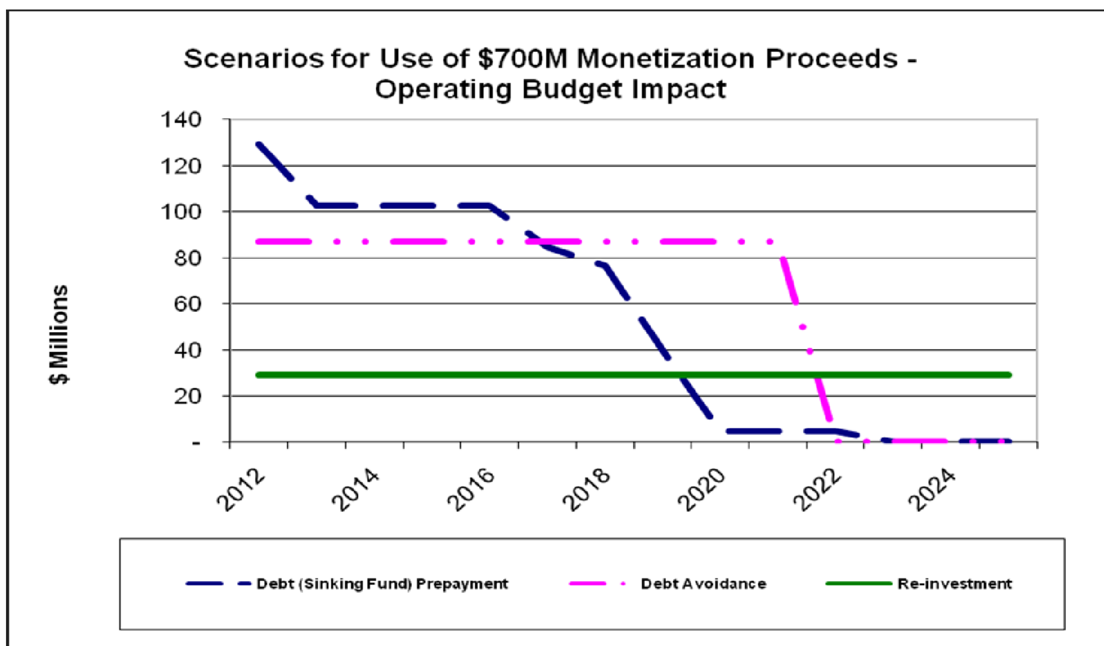
The City's investments in operating businesses are capable of generating returns higher than those the City could expect from traditional municipal investments. However, as earnings must be retained for reinvestment in the businesses for future growth, only a portion of these returns can be expected in the form of dividends or disbursements to the City.

The City could potentially increase short term revenues from the conversion of business investment assets into cash and re-investment of the entire proceeds, although at a lower expected return. However, the City would forego future dividend growth, capital gains, and public policy benefits associated with ownership. Furthermore, the City's re-investment returns would decline if the proceeds of monetization are spent. When these

factors are taken into account the benefits from asset monetization may not be compelling, unless sufficiently high prices are obtained for the assets under consideration. However, when the alternatives for funding a short term debt pressure (total debt is expected to increase significantly until 2015 and then decline) are very high tax increases, the argument for monetization is more compelling. In any case, the proceeds of monetization would be insufficient to resolve the City's fiscal sustainability challenges.

Although reinvestment of monetization proceeds into financial investments is theoretically possible, given the expected growth in City debt in the next five years a more reasonable alternative would be debt reduction. The interest cost of City debt is historically very similar to its re-investment returns at about 5%, so the business considerations are similar to re-investment in securities, i.e. bond funds or money market investments. However, when the City issues debt it must also budget for debt principal repayment, adding another 8% or so to the debt service cost (for ten year debt). As a result, monetization proceeds used to avoid debt issuance can lead to a budget impact of about 13% of the total proceeds over a ten year period, at which time the budget benefit is depleted. Larger budget impacts over shorter periods can also be produced through prepayment of sinking fund obligations as was done in the case of the Toronto Hydro Promissory Note earlier this year.

The table below illustrates different operating budget impacts over time from three options for application of hypothetical sale proceeds of $700 million, the same example used in the Long Term Fiscal Plan Update. These include re-investment of proceeds i.e. hold in reserves, debt avoidance (funding planned capital expenditures), and debt pre-payment (contribution to sinking funds). The graph illustrates that the higher the operating impact, the shorter the duration of the benefit, and that even with a significant monetization, long term budget relief is modest compared to expected future budget pressures.



It should be noted that the above benefits would provide an offset against budget pressures in the first year but would not solve future years' pressures. For example, placing $700 million in a reserve fund would generate investment returns that would reduce budget pressures by approximately $35 million. There would be no additional offset against budget pressures in subsequent years once this amount was built into the base. By contrast, the City is facing annual additional operating pressures of between $75 million and $100 million, as outlined in the staff presentation to the Budget Committee in March, 2010 on the Long Term Fiscal Plan Update. As such, an investment of this size would serve to offset less than half of one year's pressures but would not solve the ongoing mismatch between annual growth in expenditures and revenues. Also, monetization would invariably impact the existing revenue streams that the City enjoys from its investments such as THC dividends reducing the net operating benefit.

Policy and Governance Implications

The operations of the TPA, THC and Enwave are intertwined with the City's public policy objectives. For example, THC, through its subsidiaries, owns and operates street lights on behalf of the City, provides energy retrofit and generation work under contract, cooperated in the development of a Sustainable Energy Plan with the City, and developed its conservation and demand management and renewable energy investment strategies with due regard for the City's sustainability aspirations. Similarly, Enwave not only provides district heating and cooling services to City facilities, but the Deep Lake Water Cooling development and commercialization of Enwave's district energy operations has worked in concert with the City's sustainability and economic development goals. The TPA provides parking as an integral component of the City's transportation system.

After a monetization, the City's ability to influence certain public policy objectives through cooperation with these business corporations may be reduced – particularly if the City cedes ownership control. Operational directions to the board, or conditions of sale imposed on the new owner, may negatively affect the proceeds of sale, and must respect the rights of all shareholders. However, the sale of a minor share of the City's ownership should not have significant impact on the City's current goals and objectives (such as value, environmental impact, and income stream) being met with respect to these assets. Even in the case of sale of a controlling interest, certain contractual terms can be negotiated as part of the sale agreement to try to maintain certain priorities.

COMMENTS

1. Toronto Parking Authority

The Toronto Parking Authority forms an essential component of the city's commercial infrastructure in providing both on-street and off-street parking for its customers. In addition to contributing to the creation and maintenance of a healthy and vibrant commercial core and retail neighbourhood areas, it has generated significant financial returns for the City from both parking operations and the active management of its property portfolio to acquire key sites and to unlock value in its existing assets.

It continues to explore ways of creating additional value, and has identified a variety of options that require further study, including:

- Continuing to manage its property portfolio including disposing of facilities which no longer provide a necessary service and intensifying use at appropriate locations;
- Continuing to extract operating efficiencies from its existing facilities;
- Establishing additional facilities in areas of need ; and
- Monetizing part of the TPA's future revenue stream.

The TPA has engaged KPMG to outline and examine a range of monetization options. When completed, the report and its findings will be presented to the TPA Board of Directors.

2. Toronto Hydro Corporation

THC is a holding corporation incorporated in 1999 under the *Electricity Act,* 1998, as amended, and the *Business Corporations Act, Ontario*. It owns two operating subsidiaries:

- Toronto Hydro-Electric System Limited (THESL) - distributes electricity and engages in Conservation and Demand Management activities; and
- Toronto Hydro Energy Services Inc. (THESI) - provides street lighting and certain energy services to the City.

The principal business of THC is the distribution of electricity by THESL which owns and operates an electricity distribution system, delivering electricity to approximately 690,000 customers located in the City of Toronto. THESL is one of the largest municipal electricity distribution corporation in Canada and distributes approximately 18% of the electricity consumed in Ontario. The business of THESL is regulated by the Ontario Energy Board (OEB) which has broad powers relating to licensing, standards of conduct and service and the regulation of rates charged by THESL and other electricity distributors in Ontario. The City of Toronto is the sole shareholder of THC.

In 2009, THC had revenues of $2.46 billion and net income of $42.1 million on equity of almost $1 billion. Dividends of the greater of 50% of the net income or $25 million are paid annually to the City. THESL is poised for significant internal growth through capital renewal expenditures, which are increasing rapidly. As THESL earns a regulated rate of return on eligible invested capital, earnings are expected to increase accordingly.

THESL is continuing to make significant advancements in conservation and demand management, and opportunities may exist for THESI/THESL to move into energy generation such as wind farms and co-generation development.

THC is wholly owned by the City. The City, as shareholder, has established its relationship with THC through its Shareholder Direction to THC's Board of Directors. Standing Council policy is that the City is to maintain ownership of THC as long as the proceeds from sale would be no better than continuing to retain the asset. In addition, Council has directed THC to maintain or increase its value and to improve the environmental impacts related to THC and its operations. Excerpts from the Shareholder's Direction regarding Council Objectives are contained in Appendix A.

Monetization Potential

While retaining ownership, the City has benefited from significant dividend revenues and equity growth. The potential proceeds from the sale of an equity interest in a corporation like THC will depend on the specifics involved in the sale (special characteristics of the corporation, such as controlling vs. minority interest, and governance attributes) and the market conditions at the time of sale.

However, the option to divest has never been attractive due to the applicable tax and payments-in-lieu on the proceeds of a sale, which could run into the hundreds of millions of dollars. Any sale of a greater than 10% interest triggers a Provincial payments-in-lieu 'departure tax' on the increased value of the assets since incorporation, and a transfer tax of 33% on the portion of the corporation's total value sold, less any accumulated payments-in-lieu of income tax or departure tax previously paid. Additionally, any sale by THC of THESL and any sale of a 20% interest or greater of THESL must be approved by the Ontario Energy Board (OEB). These rules continue to make sale of greater than 10% an unattractive option.

Under the current tax rules the City could consider a sale of up to 10% and likely maintain control over its strategic and governance objectives. However, the share value of a small minority position may not provide optimal returns, and depending on the conditions around the sale, could also negatively affect the potential proceeds from any subsequent sale of shares.

If the Province were to amend these rules to further facilitate private investment in and consolidation of local distribution companies, and to release municipal investment for higher municipal priorities, the City might find that the financial proceeds of sale into a receptive market exceed the benefit of retained ownership. In this case the decision on whether to sell or what portion to sell could be based on timing considerations to ensure optimal sale proceeds, and strategic issues around control and governance of the corporation, that might lead the City to consider retaining a majority stake in the corporation. Therefore, it is being recommended that Council authorize the City Manager and the Deputy City Manager & Chief Financial Officer, in consultation with the City Solicitor to request the Province to amend the *Electricity Act,* 1998 or the regulations under that Act, to eliminate the City's obligation to pay any departure or transfer taxes applicable to the monetization of Toronto Hydro Corporation.

Regardless of changes to the ownership structure of THC, it should be noted that the main operations of THESL are regulated by the OEB. The mandate of the OEB is to protect the interests of consumers with respect to pricing, adequacy, reliability and quality of service. This is the basis for the requirement of OEB approval for any sale by THC of THESL or any purchase in excess of 20% of the value of THESL.

The following summarizes the advantages and disadvantages of the City divesting an equity interest in THC:

Advantages:
- An immediate influx of cash that could be used to reduce the City's debt load or for other high priority purposes of Council
- Potentially provides a new vehicle for THC to raise additional equity capital investment in growth (via share sale or issuance to other shareholder(s))
- Could provide a platform for sale of additional City shares in THC in the future.

Disadvantages:
- Probable dilution of dividend payments (which become City operating revenue) in proportion to amount sold (dividends of $25.2 million paid in 2009)
- Dilutes City participation in future growth in THC value
- Transfer and departure taxes would be significant if more than 10% sold
- New reporting obligations and requirement to have a new three (or more) party shareholder agreement
- Potential to diminish the value of additional shares sold subsequently
- Transaction costs (commissions and legal fees) can be significant (up to approximately 5% of proceeds)
- Potentially diminished influence over policy and financial direction.

Monetization Options

Staff have undertaken a preliminary review of a number of monetization options. It should be noted that THC is a reporting issuer under Ontario (and other jurisdictions') securities legislation and is already subject to related disclosure and procedural obligations. However, the introduction of new shareholders would increase the complexity of these requirements. Below is a table illustrating the main differences between five general approaches to monetization, characterized as follows:

- Equity sale (less than or greater than 10%), typically including either a tender to the highest bidder or a public share offering resulting in shares traded on the stock exchange. Proceeds are related to the future prospects for earnings.
- Preferred share issue (rights to dividends ahead of common shares), can be offered in the same way, but are typically priced based on an expected dividend rate, and marketed to institutional buyers.
- Sale of a securitized revenue stream. This is similar to a preferred share issuance which allows for first rights to the corporation's revenues in advance of common

shareholders. A share of future dividends over a fixed time period is pledged in return for cash.

- Lease or concession agreement, also usually associated with a specified term, and may transfer over operational control, often with a complete sale occurring at the end of the lease.

	Equity Sale Less than 10%	**Equity Sale Greater than 10%**	**Sale of Preferred Shares**	**Securitization of Future Revenue Stream**	**Lease or Concession Rights**
Gross Pre- Tax Proceeds	Low	Medium-High	Low-Medium	Medium	Medium
Potential Tax Implications	None	High	TBD	None	TBD
Transaction Costs	High	Medium	Medium	Low	High
THC ability to raise additional equity	Enabled	Enabled	Impaired	Impaired	Impaired
Governance Implications	Low	High	Low	Medium	High
City ability to raise additional funds	Enabled	Enabled	Impaired	Impaired	Impaired
Ability to Influence Policy	Partially Impaired	Impaired to eliminated	None	None	Impaired to eliminated

Appendix B provides more detail on each option.

Monetization Process Decisions

If the City were to decide to proceed with a monetization transaction, the following types of issues would have to be addressed or considered:

- the type of transaction that is most appropriate
- the portion to sell (in consideration of the potential proceeds/share price, payments-in-lieu, transfer taxes, and governance /control objectives)
- whether to proceed with a private sale to a single entity or a group of shareholders, or to proceed with the sale of publicly traded shares (initial public offering or IPO)
- timing of a sale with regard to growth projections, capital requirements, and market conditions in order to maximize sale proceeds
- how to apply the proceeds from any sale (e.g. debt reduction/avoidance, capital program, reserve contributions)
- status of Provincial tax rules if the City should want to sell more than 10%
- public perception and support for the sale
- impact on contractual relations such as street lighting services agreement
- impact on public policy priorities and governance – including priority shareholder objectives and directions such as environmental goals, dividend policy, distribution of seats on the Board of Directors, etc.

3. Enwave

Enwave is a share capital corporation under the *Business Corporations Act,* Ontario, owned by the City and BPC Penco (a subsidiary of OMERS) that provides unregulated district heating and cooling services to buildings in downtown Toronto. The City currently holds a 43% share representing an investment of $90.2 million (2008) in the corporation.

Enwave operates one of the largest district heating systems in North America, and has unique experience developing and operating its Deep Lake Water Cooling (DLWC) based district cooling system in downtown Toronto in partnership with Toronto Water. The DLWC project has been a very successful endeavour, leaving the corporation poised for continued investment and growth as the energy industry responds to new Provincial market incentives and increases in electricity prices.

Enwave has a more complex ownership arrangement because its shares are held by two shareholders, the City and an OMERS subsidiary. The governance of Enwave is described in a confidential shareholders agreement. Council's publicly stated objective in owning a 43% share of Enwave is to retain 50% Board representation, and achieve environmental and particularly CO2 reduction benefits through expansion and enhancement of district energy, deep lake water cooling and co-generation, and where possible using sustainable and renewable energy supply. With the completion and marketing of the full capacity of the DLWC project, the key element of this objective has been met. The Shareholder's Objectives adopted by the City in 1999 are contained in Appendix A.

Monetization Potential

As a part owner, the City has benefited from the significant growth in Enwave's revenues and earnings through increased equity value. However, to support this growth, the shareholders have been asked to make capital contributions from time to time. A new growth phase, which could involve investments beyond the City's borders, could place further financial demands on shareholders. If expansion is not the continued emphasis of the corporation, it would be more likely to begin paying dividends sooner.

The potential proceeds from the sale of an equity interest in a corporation like Enwave are generally determined by the market as a multiple of the corporation's earnings before interest, taxes, depreciation and amortization (EBITDA), less outstanding debt. Specific figures are not publicly available due to confidentiality commitments, but have been trending upward since incorporation. Proceeds would also depend on the specifics involved in the sale (special characteristics of the corporation, controlling vs. minority interest, governance attributes) and the market conditions at the time of sale.

Enwave is not subject to OEB regulation the way THESL is. However, Provincial policies in regard to electricity pricing and renewable electricity feed-in tariffs do impact the alternatives available in the heating and cooling marketplace. Provincial pricing

policies regarding clean energy such as provided by Enwave are expected to be clarified in the near future.

The following summarizes the advantages and disadvantages of monetizing the City's equity interest in Enwave:

Advantages:
- An immediate influx of cash that could be used to reduce the City's debt load or for other higher priority purposes of Council
- Eliminates City risk of ownership dilution or requirement for additional investment through capital calls
- Potentially gives Enwave the ability to raise additional equity capital for investment in growth (via share sale/issuance to new shareholder(s))

Disadvantages:
- Reduces City participation in future growth in Enwave value
- Diminishes or eliminates the City's ability to influence the mandate and objectives of Enwave
- Transaction costs can be significant (up to approximately 5% of proceeds)
- Enwave has two shareholders therefore the complexity of the transaction is greater.

Monetization Options

Staff have undertaken a preliminary review of monetization options for Enwave. Below is a table illustrating the main differences between three general approaches to monetization, which include:

- The sale of the City's interest in Enwave through a private sale or public share offering
- The sale of the City's interest in Enwave to Toronto Hydro Corporation (THC)
- Restructuring of the corporation to isolate the current investment cash generating activities from future growth initiatives to facilitate dividends.

	Equity Sale	Sale to THC	Restructuring
Potential Gross Proceeds	High	Medium	N/A
Transaction Costs	High	Low	Medium
Enwave ability to raise additional equity	Enabled	Potentially enabled	Potentially enabled
Governance Implications	High	Medium	Medium
City ability to raise additional funds	Low	Low	Low
Ability to influence Public Policy	Impaired	Low	Impaired

Appendix B provides more detail on each option.

Monetization Process Decisions

The following is a list of the type of issues that would have to be addressed prior to the conclusion of any sale transaction involving Enwave:

- discussions and agreement with the other shareholder in regard to clearing the path for a monetization transaction
- discussions with THC exploring the potential sale of the City's shares to THC
- optimal timing of a sale with regard to growth projections, capital requirements, and market conditions in order to maximize sale proceeds
- decisions on how to apply the proceeds from any sale (e.g. debt reduction/avoidance, capital program, reserve contributions)
- public perception and support for a sale of the City's equity stake in Enwave
- impact on public policy priorities and governance – including priority shareholder objectives and directions such as environmental goals, dividend policy, and distribution of seats on the Board of Directors.

4. Monetization Process and Timelines

It is anticipated that any chosen monetization process would require at least 8-9 months to complete, incorporating approvals at a minimum of two Council decision points. At the first Council meeting, approval would be sought to retain a sale manager (if proceeding with a sale) and/or financial advisor, and legal advisor, and to proceed with a particular monetization strategy. At the second Council meeting, final terms, bidders, and expected proceeds would be presented, and direction sought regarding whether or not to proceed with a transaction.

5. Next Steps

It is recommended that the Province be requested to amend the tax rules affecting a potential sale of all or a portion of Toronto Hydro Corporation so that the City would have a broader set of practical monetization options to consider.

Should Council decide that it would like to proceed with the potential monetization of either THC or Enwave, City staff would then seek Council approval to retain the services of both financial and legal advisors.

A report from the Toronto Parking Authority on the potential for monetization is currently being researched and is soon expected to be presented to the Board of the TPA.

CONTACT

Len Brittain, Director, Corporate Finance
E-mail: lbrittai@toronto.ca; Tel.: (416) 392-5380

SIGNATURE

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Joseph P. Pennachetti City Manager	Cam Weldon Deputy City Manager & Chief Financial Officer

ATTACHMENTS

Appendix A – Toronto Hydro Corporation/Enwave Shareholder Objectives and Shareholder Direction Governing Principles

Appendix B – Toronto Hydro Corporation & Enwave Sale Options

Appendix A

Toronto Hydro Corporation/Enwave Shareholder Objectives and Shareholder Direction Governing Principles

THC – Shareholder Objectives (as reported on SEDAR)

The City's objectives in connection with its relationship with THC are as follows:

1. the value of THC should be maintained or increased;
2. the City's income stream from THC should be comparable to the City's estimated financial benefit if THC had been sold as a going concern;
3. THC's consumers should not be unduly impacted by the transfer of assets from the City and the Toronto Hydro-Electric Commission to THC; and
4. the environmental impacts related to THC should be improved.

THC – Shareholder Direction – Governing Principles (as reported on SEDAR)

The Shareholder Direction states that the business of Toronto Hydro is integral to the well being and the infrastructure of the City of Toronto and provides, among other things, that it is in the best interests of Toronto Hydro and the stakeholders affected by its business that Toronto Hydro conducts its affairs:

1. on a commercially prudent basis, while engaging in recruitment practices designed to attract employees from the diverse community it serves and supporting the City's objectives where consistent with Toronto Hydro's business objectives, including procurement practices that encourage participation of equity-seeking groups in a manner consistent with the energy policies established by the City from time to time, in a socially responsible manner that supports priority objectives of the City of Toronto that are consistent with Toronto Hydro's business objectives and in accordance with the financial performance objectives of the City;

2. to provide a reliable and efficient electricity distribution system that meets changing demand utilizing emerging green technologies as appropriate with an emphasis on customer satisfaction;

3. in a safe and environmentally responsible manner while working with the City to achieve its climate change objectives; and

4. in a manner that promotes energy conservation and environmental responsibility, works with the City to achieve its climate change objectives, keeps its property

and facilities clean and well maintained and free from graffiti and protects and enhances the City's urban forest.

The Shareholder Direction provides that the Board is responsible for determining and implementing the appropriate balance among these principles.

Enwave – Shareholder Objectives

The City adopted a Statement of Shareholder Objectives in 1999. These objectives are as follows:

1. the corporation conducts its business in a financially prudent manner;
2. the corporation strives to provide a rate of return equivalent to industry averages;
3. the value of the corporation and its assets be increased or maintained; and
4. the corporation assist in achieving the City's CO_2 reduction objectives through such measures as using clean energy sources, district energy, DLWC and co-generation.

Appendix B

Toronto Hydro Corporation & Enwave Sale Options

THC – Sale Options

1. Sale of Less than 10%

The City could sell up to a 10% equity ownership interest in Toronto Hydro, through either an initial public offering of shares (IPO) or through a tendered sale of shares to a strategic buyer, without triggering a departure tax and transfer tax. However, the sale of such a minor stake may not result in the optimal per share proceeds. Furthermore, depending on the structure of the sale, the total proceeds may be insufficient to justify the potential governance implications, downstream impairment of any subsequent sale proceeds, and transaction costs. As majority share holder, the City's public policy initiatives and shareholder direction would be unaffected. Procedures for making shareholder decisions would become more complicated.

2. Sale of 10% or more

The sale of a significant stake in Toronto Hydro via an IPO or sale to a strategic buyer might optimize per share and total proceeds, particularly if a controlling stake were to be tendered. However, a sale of greater than a 10% stake would result in significant tax costs into the hundreds of millions of dollars under current rules (unless tendered to exempt municipally or Provincially controlled distribution companies, which would not be expected to attract the best price).

The City could request that the Province enact legislation to provide relief from taxes on the sale of greater than a 10% equity interest. However, these taxes were implemented in part because the Province loses a significant portion of the payments-in-lieu of income tax revenue stream to the Federal government as soon as the non-municipal ownership reaches 10%. Accordingly, the Province may be reluctant to eliminate these taxes.

Ontario Energy Board approval would be required for the sale of THESL or the purchase of greater than 20% of THC's distribution business. Approval would likely depend on assurance that the sale as structured would not negatively impact the long term cost and reliability of the distribution system.

If the City were to maintain its control of Toronto Hydro as majority share holder, the City's public policy initiatives and shareholder direction could be maintained although changes in the future would be more complicated. However, if the City were to divest more than a controlling interest in the corporation (in excess of

50%), then the City would have to develop shareholder objectives in collaboration with other shareholders or via covenants agreed to at the time of sale, which could influence the value received for the shares.

3. Sale of Preferred Shares

Toronto Hydro could issue a new class of preferred shares of Toronto Hydro Corporation, that would trade on the market value of a share of dividends produced by the corporation. It is not clear whether this type of transaction would trigger the departure tax.

The market and therefore the amount of funds that can be raised in this manner, is limited. Additionally, the City's dividend revenues would be diminished, and the value of the proceeds to the City (compared to the value from monetization a direct ownership stake) may not justify the issue.

Further analysis is required to consider the tax implications of these transactions. Under this scenario, the City's public policy initiatives and governance implications would be largely unaffected.

4. Securitization of a Revenue Stream

There are financial mechanisms to sell a stream of future revenues or profits of Toronto Hydro, for a limited time or in perpetuity, in consideration for an upfront lump sum cash payment. While this type of sale is considered much less likely to trigger transaction taxes, and have little impact on corporate governance, it would result in the commensurate reduction in the City's dividend stream, and as a purely financial transaction, the price obtained would likely be less than through the sale of an equity position. There would also be implications on flexibility and value if the City were to pursue a sale of equity in Toronto Hydro in the future.

5. Granting of Lease or Concession Rights

The City could sell the right to operate Toronto Hydro via a long term lease or concession. This kind of arrangement is applicable when an asset is thought to be underperforming. Typically, the winning bidder guarantees an improved return and is compensated by rights to retain a portion of excess profits. With ownership retained by the City it may be possible to avoid triggering transaction taxes. At the end of the agreement, all rights and responsibilities can return to the shareholder, or be sold to the lessor.

A lease or concession arrangement is not currently appropriate for THC as there is no evidence that the current governance arrangement for Toronto Hydro is producing suboptimal results. In fact, through the actions of the corporation and its board of directors returns to the City surpassed expectations in recent years. Furthermore, contracts of this nature can also be very complicated and may entail

serious risks to the owner, and would be expected to also require approval of the OEB. Also, public policy initiatives could be at odds with the objectives of the lessee's primary goal of financial returns.

Enwave - Sale Options

1. Sale to a Third Party

The Shareholders Agreement includes certain protections to each shareholder should the other shareholder wish to sell to a third party. These provisions would complicate a sale process and could affect the price that could be obtained. Accordingly, the first step in pursuing a sale would be an arrangement with the other shareholder to clear the way to a mutually agreeable process.

The sale of the City's interest to a third party via an auction process could result in the highest value to the City if competitive tension is maintained through open bidding, and a strategic buyer materializes. Restrictions on eligible bidders, and conditions on the subsequent corporate administration, and the fact that the City would be selling a minority position, would reduce expected proceeds, all else equal. Alternatively, the City could, in cooperation with the other shareholder, pursue a sale through a public offering of shares. Transaction costs would differ between the two processes, but could be fairly high in percentage terms due to the relatively small overall transaction value.

2. Sale to Toronto Hydro Corporation

The Green Energy Act and related policies of the Provincial government may have created some convergence between the operational objectives of Enwave and Toronto Hydro Corporation. For example, both organizations could explore co-generation (steam and electricity) investment options. Assuming that there is a business case for combining the governance responsibilities under the THC umbrella, the City could monetize its investment in Enwave through a sale of its shares to Toronto Hydro.

A sale to Toronto Hydro would have different characteristics compared to a private sale or IPO. First, without a competitive process the sale price could be less than optimal. Ultimately the purchase would require the approval of the THC Board of Directors. However, the investment would stay within the City's corporate family, and some element of policy influence and participation in future growth could be retained. Furthermore, a sale to Toronto Hydro could be a comparably quick and inexpensive process.

3. Enwave Restructuring

Enwave has reached a stage of maturity where its current Toronto operations are close to reaching capacity and future growth opportunities could be outside of the

current system. While the City has a vested interest in continuing to have a role in the direct energy operations of Enwave within Toronto, in a time of continued fiscal constraints at the City, funds and resources may not be available to support expansion, particularly beyond Toronto's borders.

Accordingly, the City could seek to transition to the role of a more passive investor, either allowing its interest to be diluted should additional capital calls arise, or by seeking to restructure the corporation to isolate the current investment from future growth initiatives. If the current system were isolated as a stand alone investment, internal revenue generation could justify a dividend stream to the shareholders. This approach is likely to diverge from the aspirations of the other shareholder, and the shareholder agreement would likely have to be renegotiated.