



REPORT FOR ACTION WITH CONFIDENTIAL ATTACHMENT

Toronto Hydro Corporation Equity Investment Funding

Date: May 2, 2017

To: Executive Committee

From: Deputy City Manager & Chief Financial Officer

Wards: All Wards

REASON FOR CONFIDENTIAL INFORMATION

Confidential Attachment 1 to this report involves the security of property belonging to the City or one of its agencies or corporations. Confidential Attachment 1 contains recommendations that if approved by Council, will require Toronto Hydro Corporation to file a material change report with the Ontario Securities Commission under the Ontario Securities Act.

SUMMARY

The purpose of this report is to outline the implementation details for the City's \$250 million equity investment in Toronto Hydro Corporation (THC), and to restore and enhance THC's dividends payable to the City.

RECOMMENDATIONS

The Deputy City Manager & Chief Financial Officer recommends that:

1. City Council direct the Board of Directors of Toronto Hydro Corporation to issue 200 additional common shares of the Corporation, and authorize the City's purchase of all 200 shares for the aggregate subscription price of \$250 million, to be held in the City's investment portfolio, and that this purchase be made by June 30, 2017.
2. City Council amend section 1.7 of the Investment Policy to permit, as an authorized and suitable investment, the purchase of shares of Toronto Hydro Corporation pursuant to the authority of 142(5) of the Electricity Act, 1998.

3. City Council direct the City of Toronto Deputy City Manager & Chief Financial Officer to include in the 2018 preliminary budget, a plan to use some portion of the Toronto Hydro dividends enabled by the equity contribution to pay an annual return and reimburse the investment portfolio.
4. City Council adopt the confidential instructions in Confidential Attachment 1.
5. City Council direct that Confidential Attachment 1 remain confidential until such time as the Clerk receives written confirmation by Toronto Hydro Corporation that it has met its requirements under the Ontario Securities Act pertaining to the disclosure of material change to the Corporation.

FINANCIAL IMPACT

Impacts resulting from the City's \$250 million equity contribution in THC have been included in the City's 2017 operating budget. As a result of making this contribution, budgeted dividend expectations are anticipated to increase by \$50 million, to \$75 million, as compared to the November 2016 THC announcement regarding dividend reduction to \$25 million.

This report also recommends that the \$250 million equity contribution be made from the City's Investment Fund (part of the City's General Group of funds). As previously reported the transaction will allow for enhancement of dividends receivable. It will also reduce both the liquidity of the fund, and its 2017 investment return by about \$5 million per annum (relating to foregone interest earnings on other investment assets that would have otherwise been held), until returns are budgeted in 2018 and beyond.

The report recommends directing the Deputy City Manager & Chief Financial Officer include in the 2018 preliminary budget a plan to use a portion of the annual dividend payments to compensate and reimburse the Investment Fund over time.

DECISION HISTORY

On July 1, 1999, the City, as sole shareholder in THC established a Shareholder Direction to govern its ownership of THC. The Shareholder Direction has since been amended and restated several times, the last of which was in May 2013. Section 10.4 of the Shareholder Direction sets out a dividend policy for THC.

At its meeting of December 13, 14, and 15, 2016, City Council approved an equity contribution of \$250 million to THC, in order to provide support for its credit rating and balance sheet strength, and to restore and enhance THC's capacity to pay dividends to the City. The investment in shares of Toronto Hydro is specifically authorized under section 142(5) of the Electricity Act, 1998. Staff were directed to report back to Council in the 1st quarter of 2017 on the implementation details of the \$250 million equity contribution and any related matters.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2016.EX20.3>

COMMENTS

In a letter to the City Manager dated November 14, 2016, THC communicated its Board decision to reduce the dividend payable (to the City) to \$25 million annually, to mitigate rising THC debt levels. The \$250 million equity contribution in THC approved by Council is intended to address THC's debt concerns, and to allow the dividend to the City to be restored and enhanced.

It is worth noting that on April 25, 2017, Standard & Poor's revised its credit outlook on THC to "Stable" from Negative, as a result of Council's decision to offer its financial support by way of the \$250 million equity contribution.

Funding the Equity Contribution

The City's current investment policy provides that the City may invest in certain securities as set out by Ontario Regulation 610/06 to the City of Toronto Act 2006, as amended from time to time. This report recommends that the Investment Policy be amended to state that the City may also invest in shares of Toronto Hydro Corporation, based upon the statutory authority of subsection 142(5) of the Electricity Act, 1998, which permits a municipal corporation to acquire, hold, dispose of and otherwise deal with shares of a corporation incorporated pursuant to section 142 of the Electricity Act, 1998 that carries on business in the municipality.

This report recommends that the City make the full \$250 million equity contribution by June 30, 2017 from its Investment Fund, in exchange for a share issuance reflecting the increase in shareholder equity. This share issuance will help the City track the dividend income associated with the equity contribution.

The equity contribution is a non-budgetary transaction. The City's total investment amounts (including Government Business Enterprises) would remain unchanged by this transaction. The shares will be held as part of the City's investment portfolio, but the Toronto Investment Board will be precluded from their sale. There will, however, be an expectation that the \$250 million will be returned to the investment portfolio over time.

The City's investment will provide sufficient equity for THC to continue its asset reinvestment plans, restore and enhance dividends payable to the City. The City's budget for 2017 includes receipt of a THC dividend of \$75 million, which is approximately equal to the anticipated payout at 50% of 2016 annual consolidated net income.

While this equity investment will generate positive returns for the City, it is illiquid as there is no active trading market for shares of THC, and there is no expectation that the THC shares will be sold or redeemed. Consequently, it is recommended that the City's Deputy City Manager & Chief Financial Officer report back as part of the 2018 budget, with a plan to use a portion of the annual dividend amount to pay an annual return and reimburse the City's equity contribution of \$250 million to the Investment Fund over time. Reimbursement would both restore liquidity to the Investment Fund, and help position the fund for additional equity investments in the future.

THC, like all energy firms today, operates in a rapidly changing marketplace of technology and prices. Since the time of the Ontario Energy Board's rate decision for THC 2015 - 2019, based on planned revenues and capital expenditures over the period, the electricity market has been the focus of considerable policy intervention by the Provincial government. In 2016 the Climate Change Mitigation and Low-Carbon Economy Act was passed, expressing the need for investment to facilitate transition to electric vehicles. More recently, the Province has announced an extended amortization period for green energy contracts, in order to reduce the current cost of power to consumers.

CONTACT

Joe Farag, Executive Director, Corporate Finance; 416-392-8108;
Joe.Farag@toronto.ca

Robert Hatton, Director, Strategic Initiatives & Intergovernmental Finance, Corporate Finance Division; 416-392-9149; Robert.Hatton@toronto.ca

Karyn Spiegelman, Senior Financial Analyst, Strategic Initiatives & Intergovernmental Finance, Corporate Finance Division; 416-392-8894; Karyn.Spiegelman@toronto.ca

SIGNATURE

Roberto Rossini
Deputy City Manager & Chief Financial Officer

ATTACHMENTS

Confidential Attachment 1