

memorandum

DATE: October 22, 2013

TO: Hon. Mayor and Members of Council

FROM: Barbara Cribbett
Interim City Manager

RE: **COUNCIL MEETING – OCTOBER 29, 2013**
FINANCE & ADMINISTRATION COMMITTEE OCTOBER 10, 2013
REPORT 12, ITEM 1
EQUITY INVESTMENT IN POWERSTREAM CORE DISTRIBUTION

C	12
Item #	1
Report No.	12 (F+A)
Council - October 29/13	

Recommendation

The Interim City Manager recommends:

1. That the City of Vaughan agrees, in principle, to subscribe for equity common shares in Vaughan Holdings Inc. in the maximum amount of \$22,657,500; and
2. That the City of Vaughan's investment in such common shares may be made in tranches, with amounts and timing determined consistent with the dates and amounts of the additional common shares to be issued from PowerStream to Vaughan Holdings Inc. for PowerStream's core distribution business; and
3. That the Mayor, together with the City Clerk are hereby authorized to execute all documents and that staff are authorized take such steps as may be necessary or desirable in connection with the foregoing.

Economic Impact

An equity investment of up to \$22.7M in PowerStream's core distribution company is expected to provide a slightly better financial return to the City and Vaughan Holdings Inc. and will result in increase in the City's and VHI's equity value in PowerStream through the re-investment of retained earning into PowerStream's core distribution business.

Purpose

The purpose of this memorandum is to provide final recommendations for Item 1, Report 12- Finance & Administration Meeting held on October 21, 2013.

Background – Analysis and Options

The City of Vaughan is the sole shareholder of Vaughan Holdings Inc. (VHI), which in turn owns 45.315% of PowerStream Inc. The balance of shares in PowerStream Inc. are owned by the cities of Markham and Barrie, through their respective holding companies.

In early 2013, PowerStream Inc. advised the shareholders that for projected capital expenditures from 2013 to 2017, PowerStream will require new debt and equity to fund the capital program. To maintain a 60/40 debt to equity ratio, PowerStream will require a \$50 million equity investment. As a result, PowerStream has offered an opportunity to the shareholders to consider investing additional equity into the core business.

At the Vaughan Holdings Inc. Board of Directors Meeting on October 21, 2013, the Board approved the following resolution:

That Vaughan Holdings Inc. (VHI) agrees to provide its share of an additional equity investment in PowerStreams' core distribution business, being a maximum of \$22,657,500 subject to the City of Vaughan approving an equivalent equity investment in Vaughan Holdings Inc.

The VHI Board considered two options for the core distribution business equity investment. The first option was a conversion of a portion of the City's promissory notes into equity. The City currently earns 5.58% annually on the \$78.2M PowerStream promissory note, or \$4.4M. Converting all or a portion of the promissory note to equity will negatively impact the City's investment earnings due to the slightly higher rate of return for the promissory note compared to the expected dividend rate of return for an equity investment. This option was not recommended.

The second option discussed was an additional cash equity investment into PowerStream from VHI, with an equivalent equity investment into VHI from the City of Vaughan.

The City of Vaughan's Investment policy was amended in 2009 to permit equity investments in corporations incorporated under section 142 of the Electricity Act, therefore an equity investment in VHI is permitted. Investing \$22.7M of cash from the City's investment portfolio required a comparison between the expected dividend rate of return and normal rates of return for the City's investment portfolio, as well as a review of forecasted available cash flows for investment.

Comparing a 10 year bond rate to the expected returns received through dividend streams indicates that the dividend rate is slightly better, and additionally a portion of net revenues are also retained by PowerStream and re-invested into the business, therefore increasing the overall equity value. It should be noted that, unlike a 10 year bond which returns the original principal investment at the end of the 10 year period, an equity investment does not return the principal cash investment until the equity or business is sold.

As Vaughan Holdings Inc. does not have the funds on hand to make this investment, it is necessary for the City of Vaughan to mirror the investment made by Vaughan Holdings Inc. into PowerStream Inc. through an equivalent equity investment into Vaughan Holdings Inc. Essentially, the City of Vaughan is providing the cash for the \$22.7M investment. A ten year forecast of cash available for investment indicates that the City's cash flows are sufficient to accommodate the \$22.7M cash equity investment into PowerStream's core distribution business.

Conclusion

Given the slightly more attractive rate of return for an equity investment and the availability of surplus cash for investment purposes, as well as the low risk of investing in a regulated business with a proven track record, it is recommended that the City of Vaughan agree to provide its share of an additional equity investment in PowerStream's core distribution business, being a maximum of \$22,657,500.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Barbara Cribbett', with a long horizontal flourish extending to the right.

Barbara Cribbett
Interim City Manager