

CITY OF VAUGHAN

EXTRACT FROM COUNCIL MEETING MINUTES OF SEPTEMBER 20, 2016

Item 4, Report No. 9, of the Finance, Administration and Audit Committee, which was adopted without amendment by the Council of the City of Vaughan on September 20, 2016.

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POWERSTREAM MERGER AND ACQUISITION - UPDATE

The Finance, Administration and Audit Committee recommends approval of the recommendation contained in the following report of the Chief Financial Officer / City Treasurer and Director of Financial Planning and Development Finance / Deputy City Treasurer, dated September 6, 2016:

Recommendation

The Chief Financial Officer / City Treasurer and Director of Financial Planning and Development Finance / Deputy City Treasurer in consultation with the City Solicitor recommend:

1. That the City of Vaughan subscribe for additional equity common shares in Vaughan Holdings Inc. in the maximum amount of \$14,000,000 to fund Vaughan Holdings Inc.'s acquisition of Barrie Hydro Holdings Inc. share ownership in PowerStream;
2. That the City of Vaughan's investment in such common shares be made consistent with the timing and amounts deemed necessary by Vaughan Holdings Inc. up to the maximum amount;
3. That the Mayor and City Clerk be hereby authorized to execute all documents and agreements on behalf of the City with respect to the acquisition of Barrie Hydro Holdings Inc. share ownership, with content satisfactory to the Chief Financial Officer / City Treasurer and in a form satisfactory to the City Solicitor, and that City staff be authorized to take such steps as may be necessary to give effect to the acquisition of Barrie Hydro Holdings Inc. shares.

Contribution to Sustainability

The PowerStream Merger and Acquisition will help to diversify and increase the yield of the City of Vaughan's investment portfolio. This relatively stable revenue stream will contribute to increased financial sustainability over a long term horizon. Pursuing additional shares in MergeCo through acquisition of Barrie Hydro Holdings Inc. (BHHI) holdings has both financial and strategic benefits that will contribute to this sustainability.

Economic Impact

Vaughan Holdings Inc. (VHI), wholly owned by the City of Vaughan, received a formal letter from Barrie Hydro Holdings Inc. (BHHI) requesting that VHI fund \$13 million (exclusive of legal/financial advisory costs) of their equity injection required for the PowerStream Merger and Acquisition. The respective value of BHHI's share ownership in newly issued PowerStream shares (approximately 1.41%) would be provided in exchange for VHI's equity injection. This equity injection would be in addition to the City of Vaughan's previously approved \$62 million equity injection toward the upcoming hydro utility Merger and Acquisition.

The key economic impacts are discussed further in the body of this report below.

Communications Plan

The report and attachment are available publicly on the Agenda, Minutes & Extract page of the City's website (www.vaughan.ca).

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Purpose

The purpose of this report is as follows:

- To inform Council and the public on the receipt of BHHI's request to purchase a portion of BHHI's share ownership in PowerStream and subsequently MergeCo
- To request up \$14 million in funding from the City of Vaughan for VHI's portion of the acquisition of BHHI's share ownership in PowerStream by using available City cash reserves to purchase additional equity common shares in VHI
- To authorize the Mayor and City Clerk to execute the necessary documents and agreements

Background - Analysis and Options

On September 16, 2015, the VHI Board accepted PowerStream Board's resolution to enter into a three way merger with Enersource Corporation and Horizon Holdings Inc. and proceed to acquire Hydro One Brampton. On September 22, 2015 City of Vaughan's Committee of the Whole (Working Session) passed similar resolutions, which were then approved through a Special Council meeting on October 7, 2015.

On March 24, 2016, the execution of the Merger Participating Agreement (MPA) and Unanimous Shareholders Agreement (USA) took place with a signing ceremony held at Horizon Utilities in Hamilton. The signing of the MPA and USA was the final step before seeking regulatory approval. The shareholders have submitted a Mergers, Acquisitions, Amalgamations and Divestitures (MAADs) application to the Ontario Energy Board (OEB) for approval; a process estimated to take a minimum of six months. All merger participants will be required to fund their required equity injection after regulatory approval. The estimated \$125M required equity injection by PowerStream shareholders are allocated as follows: \$56.6M City of Vaughan, \$25.6M City of Barrie and \$42.7M City of Markham.

On June 7, 2016, BHHI submitted a letter to VHI, requesting that VHI purchase a portion of BHHI's equity injection of approximately \$13M in exchange for relevant share ownership in new PowerStream shares (approximately 1.41%) and therefore subsequently MergeCo (approximately 0.65%). The VHI Board, subsequently, approved the recommendation to proceed with the equity funding for BHHI, subject to a finalized term sheet and City of Vaughan Council approval.

a) Financial Analysis of BHHI request

The table below provides a cash flow analysis in which VHI provides an additional \$13M to fund a portion of BHHI's equity requirement.

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Table 1: Financial impacts

	Original Approved		City Reserves
	▼ MergeCo_1		MergeCo_2
VHI buys 1.41% of PowerStream from BHHI prior to close for \$13M			
	(\$'000)		
Equity (Cash) Investment Required in 2016			
VHI	(61,600)		(61,600)
BHHI			(13,000)
Total Equity	(61,600)		(74,600)
Net Present Value	491,015		492,780
Incremental Increase in Average Annual Cash Flow (25 years)			989
Ownership of MergeCo (%)	20.8		21.45
Change in Ownership in MergeCo (%)			0.65

Source: Navigant Model forecast

NPV discounted at 5%

It is important to note that VHI/Council has already approved the original proposed transaction of \$62M (including closing contingencies) funded by a combination of funds retained within VHI (\$16M) and the City's available reserve cash balance (\$46M).

As the above table shows, the additional \$13M investment is equivalent to 0.65% equity interest of MergeCo. The price is based on a 1.5X rate base, which is similar to the price paid by MergeCo for the acquisition of Hydro One Brampton. Navigant Consulting, the City's external financial advisor, has concurred that the 1.5X rate base price for Hydro One Brampton is reasonable and within the range of market multiples.

The City's equity interest in MergeCo would increase from 20.80% to approximately 21.45%. It is estimated that the \$13 million investment would result in an approximate increase in additional annual cash flows of \$1 million over 25 years. An additional 1\$ million is being sought for a total of \$14 million in order to account for closing costs, legal and financial advisory services, however a similar investment yield and payback period is expected even after the closing costs are considered.

Funding by City reserves is preferred

The additional equity injection under BHHI request can be funded by using either the City's cash available from reserves or converting the promissory note held in PowerStream. Currently, the City has a promissory note of approximately \$86.9 million with PowerStream. Funding the \$13 million equity from City reserves would result in a higher net present value than converting the promissory note and is therefore being recommended as the funding source.

Incremental annual cash flow will first be used to pay back City's reserve over a 10 to 20 year period

As noted above, the investment would result in an expected average annual cash flow increase of approximately \$1 million. This incremental cash flow would be used to pay back the City's cash reserves for the \$13 million investment as the reserves are earmarked for the City's future capital program. The plan would be to pay back the reserve draw over the next 10 to 20 years and the amount / term of the pay back would be determined through future budget cycles.

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b) Legal agreement of BHHI funding request

An external Legal Counsel, Gowlings LLP, has been engaged to provide legal advice and to work on an agreement with BHHI should Council approve the recommendation to provide funding. The final content and form of the agreement would be authorized by the Mayor and City Clerk on a delegated basis, with content satisfactory to the Chief Financial Officer / City Treasurer and in a form satisfactory to City's Solicitor. Should negotiations between VHI and BHHI be required that are substantially outside the parameters of this report then staff will bring back any such terms to Council for final approval.

Regional Implications

Not applicable

Conclusion

The funding request from BHHI would require an additional equity injection of \$13 million (plus legal and financial advisory costs). The recommended funding method would be to use City cash reserves as the cash flows, net present values and returns are beneficial to VHI and in turn to the City of Vaughan.

While a formal legal agreement is currently being finalized between VHI and BHHI, staff is recommending that Council delegate authority to the Mayor and City Clerk to execute the agreement with content satisfactory to the Chief Financial Officer / City Treasurer and in a form satisfactory to the City's Solicitor.

Attachments

None.

Report prepared by:

Jackie Macchiusi, Senior Manager, Corporate Financial Planning and Analysis
Alex Ly, Senior Financial Analyst, Investments

POWERSTREAM MERGER AND ACQUISITION - UPDATE**Recommendation**

The Chief Financial Officer / City Treasurer and Director of Financial Planning and Development Finance / Deputy City Treasurer in consultation with the City Solicitor recommend:

1. That the City of Vaughan subscribe for additional equity common shares in Vaughan Holdings Inc. in the maximum amount of \$14,000,000 to fund Vaughan Holdings Inc.'s acquisition of Barrie Hydro Holdings Inc. share ownership in PowerStream;
2. That the City of Vaughan's investment in such common shares be made consistent with the timing and amounts deemed necessary by Vaughan Holdings Inc. up to the maximum amount;
3. That the Mayor and City Clerk be hereby authorized to execute all documents and agreements on behalf of the City with respect to the acquisition of Barrie Hydro Holdings Inc. share ownership, with content satisfactory to the Chief Financial Officer / City Treasurer and in a form satisfactory to the City Solicitor, and that City staff be authorized to take such steps as may be necessary to give effect to the acquisition of Barrie Hydro Holdings Inc. shares.

Contribution to Sustainability

The PowerStream Merger and Acquisition will help to diversify and increase the yield of the City of Vaughan's investment portfolio. This relatively stable revenue stream will contribute to increased financial sustainability over a long term horizon. Pursuing additional shares in MergeCo through acquisition of Barrie Hydro Holdings Inc. (BHHL) holdings has both financial and strategic benefits that will contribute to this sustainability.

Economic Impact

Vaughan Holdings Inc. (VHI), wholly owned by the City of Vaughan, received a formal letter from Barrie Hydro Holdings Inc. (BHHL) requesting that VHI fund \$13 million (exclusive of legal/financial advisory costs) of their equity injection required for the PowerStream Merger and Acquisition. The respective value of BHHL's share ownership in newly issued PowerStream shares (approximately 1.41%) would be provided in exchange for VHI's equity injection. This equity injection would be in addition to the City of Vaughan's previously approved \$62 million equity injection toward the upcoming hydro utility Merger and Acquisition.

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Purpose

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- To inform Council and the public on the receipt of BHHL's request to purchase a portion of BHHL's share ownership in PowerStream and subsequently MergeCo
- To request up \$14 million in funding from the City of Vaughan for VHI's portion of the acquisition of BHHL's share ownership in PowerStream by using available City cash reserves to purchase additional equity common shares in VHI
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Background - Analysis and Options

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On June 7, 2016, BHHI submitted a letter to VHI, requesting that VHI purchase a portion of BHHI's equity injection of approximately \$13M in exchange for relevant share ownership in new PowerStream shares (approximately 1.41%) and therefore subsequently MergeCo (approximately 0.65%). The VHI Board, subsequently, approved the recommendation to proceed with the equity funding for BHHI, subject to a finalized term sheet and City of Vaughan Council approval.

a) Financial Analysis of BHHI request

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The City's equity interest in MergeCo would increase from 20.80% to approximately 21.45%. It is estimated that the \$13 million investment would result in an approximate increase in additional annual cash flows of \$1 million over 25 years. An additional \$1 million is being sought for a total of \$14 million

in order to account for closing costs, legal and financial advisory services, however a similar investment yield and payback period is expected even after the closing costs are considered.

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Regional Implications

Not applicable

Conclusion

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Attachments

None.

Report prepared by:

Jackie Macchiusi, Senior Manager, Corporate Financial Planning and Analysis
Alex Ly, Senior Financial Analyst, Investments

Respectfully submitted,

Laura Mirabella-Siddall, CPA, CA
Chief Financial Officer,
City Treasurer

Lloyd Noronha, CPA, CMA
Director, Financial Planning and Development Finance,
Deputy City Treasurer