



The Corporation of the Town of Milton

Report To: Council

From: Glen Cowan, Chief Financial Officer / Treasurer

Date: May 25, 2020

Report No: CORS-025-20

Subject: Milton Hydro Borrowing Limit

Recommendation:

1. THAT the borrowing limit for Milton Hydro Distribution Inc. (MHDI) be increased to \$80,000,000, subject to the following conditions being maintained by MHDI:
 - a. The debt to capital ratio remaining at or below 60%
 - b. The current ratio remaining above 1.1:1
 - c. The debt service coverage ratio remaining above 1.15:1
2. THAT MHDI annually provide to the Town's Treasurer an annual compliance letter or waiver with respect to the covenants.
3. THAT the future borrowing of Milton Energy and Generation Solutions Inc. (MEGS) remain contingent on the approval of Town Council following the presentation of a business case related to each initiative.

EXECUTIVE SUMMARY

- Milton Hydro currently has an approved borrowing limit of \$60 million. In addition, several project specific borrowings have been approved in relation to initiatives undertaken by MEGS.
- The Board of Directors for MHHI have requested an increase in the borrowing limit to \$100 million in consideration of the needs of both MHDI and MEGS.
- Separate approval of an \$80 million limit for MHDI while continuing project-specific approval for MEGS is recommended in recognition of the different nature and risk profile of the two subsidiaries.
- It is also recommended that the \$80 million limit be contingent on the satisfaction of three financial measures. These measures are also currently reflected as covenants in the existing borrowing agreements with other lenders.
- When combined, these recommendations are expected to satisfy the requirements of MHHI and its subsidiaries, while allowing the Town as the sole shareholder to maintain an appropriate level of oversight and risk mitigation.



REPORT

Background

Milton Hydro Holdings Inc. (MHHI) is a corporation existing under the Business Corporations Act, which succeeded the electricity business known as Milton Hydro Electric Commission. MHHI has two subsidiaries¹:

- Milton Hydro Distribution Inc. (MHDI) oversees electricity distribution
- Milton Energy and Generation Solutions Inc. (MEGS) oversees unregulated services²

The Town of Milton is the beneficial owner of all of the issued shares of Milton Hydro Holdings Inc. (MHHI) and approved a shareholder's direction for MHHI in 2000, which established certain principles of governance without restricting the powers of the Board to manage or supervise the management of the Corporation.

In the shareholder's direction (By-law 076-2000), section 5.2(j) states that the shareholder must approve all borrowings exceeding \$5,000,000. Since 2000, the following approvals have been granted:

- Limit was increased to \$8,000,000 on April 22, 2002 via CS-030-02
- Limit was increased to \$22,252,257 on September 28, 2009 via CORS-081-09
- Limit was increased to \$60,000,000 on September 24, 2012 via CORS-072-12

In addition, the following approvals were provided specific to initiatives of MEGS

- \$5,100,000 for the solar power and combined heat energy initiatives on December 12, 2016 through COMS-024-16
- \$10,500,000 for the vanadium redox battery project on September 16, 2019 per CORS-058-19

At its meeting on February 24, 2020, the Board of MHHI passed the following resolution:

The Board of Directors of Milton Hydro Holdings Inc. (MHHI), Milton Hydro Distribution Inc. (MHDI) and Milton Energy and Generation Solutions Inc. (MEGS) authorizes entering into a new financing agreement with TD and/or Ontario Infrastructure and Lands Corporation ("OILC") and authorizes the borrowing of up to \$100,000,000, subject to seeking the approval of the

¹ Through CORS-004-20 direction was provided to dissolve Milton Hydro Services Inc. (MHSI) and merge its functions into MEGS.

² On September 16, 2019, Milton Council received Staff Report CORS-058-19 and approved the joint venture with Baseload Power Corporation and eventual acquisition by MEGS of a newly incorporated entity owned by Baseload Power Corporation or its principal owner, which is to become a subsidiary of MEGS, subject to terms and conditions that are to the satisfaction of MEGS.



Shareholder pursuant to the Shareholder Direction dated September 20, 2000 and amended thereafter.

A copy of the formal request on behalf of the Board is provided herein as Appendix 1. This report, CORS-025-20, has been prepared in response the request of MHHI.

Discussion

Summary of Existing Debt

As of 2019 year end, MHHI had \$67.1 million in long term debt recorded on its balance sheet. \$57.9 million relates to MHDI and \$9.2 million relates to MEGS. For the year 2019, MHHI paid approximately \$2.9 million in interest expense related to its long-term debt (\$2.6 million related to MHDI and \$0.3 million related to MEGS).

In the letter attached as Appendix 1, a description of the amounts issued by both MHDI and MEGS is provided, with characteristics including:

- The debt is generally held by a combination of Infrastructure Ontario as well as MHHI's financial institution
- The debt held by MHDI generally has a term of 25 to 30 years, with amortizing payments (principal and interest) made on either a monthly or semi-annual basis
- The debt held by MEGS is with the financial institution involving both demand loans with interest-only monthly payments as well as term loans with blended payments (principal and interest).

In addition to the amounts noted in the appendix, the \$57.9 million related to MHDI at year end also includes the \$14.9 million note that is payable to the Town with interest-only payments made annually.

The following table presents several relevant ratios with respect to MHHI's leverage at 2019 year end. These figures will be discussed in the analysis and recommendations below.

Table 1 - Financial Ratios based on 2019 Financial Statements

	MHDI	MEGS	MHHI
Debt to Capital Ratio <i>Debt / (Debt + Equity)</i>	56%	90%	59%
Interest Coverage Ratio <i>Income from Operating / Finance Costs</i>	3.0	3.7	3.1
Current Ratio <i>Current Assets / Current Liabilities</i>	1.4	0.8	1.3



Planned Debt Utilization

Appendix 1 outlines the intention for the increased debt limit as follows:

- \$12 million to support MHDI’s 3-year capital program
- A 6-month temporary increase in the operating line from \$4 million to \$8 million in response to COVID-19

The capital investments are related to system access, renewal and service projects, and form part of supporting a growing community. The \$12 million identified was incorporated into MHDI’s 2020 budget and forecast. Through that process, MHDI’s forecast demonstrated that the forecasted cash flow could accommodate the interest as follows:

Table 2 - Forecasted Financial Ratios for MHDI based on 2020 Budget

	Limit	2020	2021	2022	2023
Debt to Capital Ratio	Maximum 60%	56.8%	57.3%	57.6%	57.8%
Debt Service Coverage Ratio*	Minimum 1.15:1	1.56	1.63	1.66	1.69
Current Ratio	Minimum 1.1:1	1.63	1.64	1.66	1.69

* Debt service coverage ratio = (EBT + Interest + Depreciation/Amortization - Cash Taxes Paid - 40% Capex) / (Principal + Cash Interest Expense)

The temporary needs related to the current pandemic have arisen since the finalization of the 2020 Budget.

Summary of Recommendations

The formal request received from MHHI spoke to a request to increase the overall debt limit for MHHI to \$100 million. This amount would facilitate the needs of both MHDI and MEGS.

The recommendations contained herein instead provide separate authorities related to each MHDI and MEGS. This approach has been utilized to better reflect the nature and risk profile related to each of the subsidiaries, and more closely aligns with the way the debt limit approvals have been provided in recent years. This approach is also expected to satisfy the needs of MHHI as articulated in the letter attached from MHHI.

1. MHDI - \$80 million debt limit

The investment needs of MHDI relate to the regulated services provided and therefore the revenue that is expected to fund the resulting debt charges will

require approval by the Ontario Energy Board (OEB) through the rate-setting process.

The OEB uses a deemed capital structure of 60% debt, 40% equity for electricity distributors when establishing rates. The deemed capital mix is equal to a debt to equity ratio of 1.5 (60/40). A debt to equity ratio of more than 1.5 indicates that a distributor is more highly levered than the deemed capital structure. A high debt to equity ratio may indicate that an electricity distributor may have difficulty generating sufficient cash flows to make its debt payments. A debt to equity ratio of less than 1.5 indicates that the distributor is less levered than the deemed capital structure. A low debt-to-equity ratio may indicate that an electricity distributor is not taking advantage of the increased profits that financial leverage may bring.

The 60% debt to capital ratio was also supported by previous reviews undertaken for Milton Hydro, such as the analysis previously provided by Morrison Park Advisors, that recommended migrating to a capital structure that was more in line with the OEB policies. This measure better supports MHDl's ability to deliver an appropriate dividend to the shareholder on a sustainable basis.

The recommendations within this report provide for a revised limit of \$80 million for MHDl, subject to three specific requirements related to the overall capitalization, liquidity and cash flow.

- The \$80 million provides for the existing amount of debt of \$57.9 million, the additional \$12.0 million capital program requirement, the temporary borrowing capacity of \$4.0 million, plus an allowance for both existing but unutilized credit facilities as well as potential future needs.
- The three new requirements assure the shareholder that appropriate limitations are in place with respect risk management, and align with existing covenants that MHDl adheres to with existing lenders.

2. MEGS Approvals on a Project-specific Basis

As MEGS delivers MHHI's unregulated services, the nature of its investments and revenue stream differ from that of MHDl. In recent years, Town Council approval of debt for MEGS have related to solar power, combined heat and power and battery projects where the request for financing has been accompanied by a detailed report to Council for each initiative. The differences between the subsidiaries is also demonstrated in the financial ratios presented above, as MEGS utilizes a much higher reliance on debt financing with a debt to capital ratio of 90% and currently has a current ratio below 1.

As such, it is recommended that the debt requirements of MEGS continue to be presented on a project specific basis in the future to ensure appropriate



The Corporation of the Town of Milton

Report #:
CORS-025-20
Page 6 of 6

consideration of the costs, benefits and risks associated with each unique initiative.

Financial Impact

As the sole shareholder of MHHI, the Town has a vested interest in the financial health of the organization including each subsidiary. The capital structure adopted by MHHI, MHDl and MEGS has a direct impact on cash flow associated with each entity and therefore the ability of each to provide a return to the shareholder in the form of a dividend.

The additional debt capacity recommended in this report will allow MHDl to provide its services to a growing community, as well as to manage its cash flow during the uncertainty created by COVID-19. The covenants added through the recommendations will ensure appropriate limits are maintained with respect to cash flow and the balance sheet.

Town Council will also be afforded the opportunity to consider future initiatives related to MEGS in the same way recent approvals have been provided for the battery, solar and combined heat and power projects.

Respectfully submitted,

Troy McHarg
Commissioner, Corporate Services / Town Clerk

For questions, please contact: Glen Cowan

Phone: Ext. 2151

Attachments

Appendix 1 – Letter from MHHI dated April 24, 2020

CAO Approval
Andrew M. Siltala
Chief Administrative Officer



MILTON HYDRO HOLDINGS INC.

200 Chisholm Drive, Milton, Ontario, L9T 3G9
Telephone (905) 876-4611 • Fax (905) 876-2044

April 24, 2020

Mr. Glen Cowan
Chief Financial Officer & Treasurer
Town of Milton
150 Mary Street
Milton ON, L9T-6Z5

Dear Glen:

Milton Hydro Distribution Inc. ("MHDI") is in the process of securing third party financing for capital projects over the next 3-year period in the amount of \$12,000,000. The \$12,000,000 credit facility will be drawn down in \$4,000,000 instalments over a 3-year period to support MHDI's capital program.

MHDI's approved Budget calls for the following capital expenditures, net of capital contributions, over the next 3-year period. Drawdowns will require separate Board approval as capital funding is required.

	Capital Project Plan	Debt (60%)	MH Funded
2020 Capital Projects	\$ 6,685,000	\$4,000,000	\$ 2,685,000
2021 Capital Projects	\$ 7,010,000	\$4,000,000	\$ 3,010,000
2022 Capital Projects	\$ 7,010,000	\$4,000,000	\$ 3,010,000

We have also recently requested a temporary increase in our Operating Line from \$4,000,000 to \$8,000,000 to deal with the pandemic impact. The temporary increase will be in place for 6 months and revisited at that time.

At our Board meeting on February 24, 2020, the following motion was approved.

RECOMMENDATION / MOTION:

Whereas, the Shareholder Direction dated September 30, 2000, under section 5.2(j) states that the Shareholder must approve all borrowings exceeding \$5,000,000; and

Whereas, on April 22, 2002, the Shareholder approved an increase in Milton Hydro Holdings Inc.'s borrowing limit to \$8,000,000 million; and

Whereas, on September 28, 2009, the Shareholder approved an increase in Milton Hydro Holdings Inc.'s borrowing limit to \$22,252,257; and

Whereas, on September 24, 2012, the Shareholder approved an increase in Milton Hydro Holdings Inc.'s borrowing limit to \$60,000,000; and

And Whereas, Milton Hydro Holdings Inc.'s debt financing for 2020 includes an additional \$4.0 million for MHDl capital projects and \$7.9 million for the balance of the MEGS Battery project bringing the total debt financing including the new debt to Milton Hydro Holdings Inc. and its subsidiaries to \$67.4 million (MHDl Operating Line - \$4.0 million; MHDl Letter of Credit with IESO - \$3.0 million; MHDl IO/TD - \$43.0 million less principle payments of \$1.53 million; MEGS TD - \$6.8 million less principle payments of \$2.2 million; MEGS Battery project in process -\$2.4 million);

BE IT RESOLVED THAT:

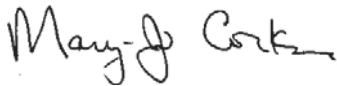
The Board of Directors of Milton Hydro Holdings Inc. (MHHI), Milton Hydro Distribution Inc. (MHDl) and Milton Energy and Generation Solutions Inc. (MEGS) authorizes entering into a new financing agreement with TD and/or Ontario Infrastructure and Lands Corporation ("OILC") and authorizes the borrowing of up to \$100,000,000, subject to seeking the approval of the Shareholder pursuant to the Shareholder Direction dated September 20, 2000 and amended thereafter.

Moved By: William Swan
Seconded By: David Cardin

A copy of the financing agreements in place is attached as Appendix A.

We would appreciate bringing forth the resolution to the Shareholder, the Town of Milton, at your earliest convenience.

Kindest regards,
Yours truly,



Mary-Jo Corkum, CPA, CA
Secretary/Treasurer

Appendix A:

Milton Hydro Distribution Inc.

Infrastructure Ontario

Milton Hydro signed a financing agreement dated December 8, 2015 with Infrastructure Ontario for \$4.0M, amending agreements relating to the 2009 and 2013 Financing Agreements, a new Pari-Passu agreement that was agreed to by both IO and TD and a revised General Security Agreement.

MHDI has drawn down \$15,752,257 under the existing Financing Agreement No. 09Mil930079055FA with Infrastructure Ontario dated November 12, 2009.

	Debenture #1	Debenture #2	Debenture #3	Debenture #4	Debenture #5	Debenture #6	Total
Principal Amount	\$285,000	\$2,880,057	\$4,000,000	\$3,487,200	\$2,550,000	\$2,550,000	\$15,752,257
Closing Date	01-Apr-10	01-Apr-10	15-Jul-10	15-Sep-11	15-Feb-12	17-Sep-12	
Maturity Date	01-Apr-16	01-Apr-25	16-Jul-35	15-Sep-36	16-Feb-37	17-Sep-37	
Annual Interest Rate	3.02%	4.49%	4.84%	4.33%	3.92%	3.87%	
Loan Term	5 years	15 years	25 years	25 years	25 years	25 years	
Payment Frequency	Semi Annual	Semi Annual	Semi Annual	Semi Annual	Semi Annual	Semi Annual	
Loan Type	Amortizing	Amortizing	Amortizing	Amortizing	Amortizing	Amortizing	

MHDI has drawn down \$20.044M under the Financing Agreement No. 12Mil9300712059FA with Infrastructure Ontario dated March 27, 2013 relating to Milton Hydro's contribution for the Tremaine Transformer Station and capital projects from 2011-2015.

	Promissory Note	Promissory Note	Promissory Note	Promissory Note	Promissory Note	Total
Principal Amount	\$3,044,000	\$3,900,000	\$7,800,000	\$4,000,000	\$1,300,000	\$20,044,000
Closing Date	01-May-13	15-Jul-14	15-Sep-14	01-Jul-15	01-Sep-15	
Maturity Date	01-May-38	15-Jul-39	15-Sep-39	01-Jul-40	01-Sep-40	
Annual Interest Rate	3.74%	3.97%	3.04%	3.55%	3.31%	
Loan Term	25 years	25 years	25 years	25 years	25 years	
Payment Frequency	Semi Annual	Semi Annual	Semi Annual	Semi Annual	Semi Annual	
Loan Type	Amortizing	Amortizing	Amortizing	Amortizing	Amortizing	

MHDI drew down \$4.0M under the Credit Facility Agreement with Infrastructure Ontario dated December 8, 2015 relating to Milton Hydro's contribution for capital projects 2015 to 2020.

	Promissory Note	Promissory Note	Total
Principal Amount	\$3,000,000	\$1,000,000	\$4,000,000
Closing Date	15-Dec-16	16-Dec-19	
Maturity Date	15-Dec-46	16-Dec-49	
Annual Interest Rate	3.74%	3.10%	
Loan Term	30 years	30 years	
Payment Frequency	Semi Annual	Monthly	

Loan Type	Amortizing	Amortizing	
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TD Bank:

On December 11, 2015, Milton Hydro signed a Pari Passu Agreement with TD and IO and a new TD bank agreement. The agreement includes an Operating Line (\$4,000,000) and a Letter of Credit with the IESO of \$3,000,000. The agreement includes \$12 million in Long Term Facilities in \$4M increments. On December 22, 2015 and July 20, 2018, Milton Hydro drew down \$4 million respectively. On October 4, 2019, Milton Hydro drew down \$3 million.

	Interest Swap	Interest Swap	Interest Swap	Total
Principal Amount	\$4,000,000	\$4,000,000	\$3,000,000	\$11,000,000
Closing Date	22-Dec-15	20-Jul-18	04-10-19	
Maturity Date	22-Dec-45	20-Jul-48	04-10-49	
Annual Interest Rate	3.58%	3.90%	3.146%	
Loan Term	30 years	30 years	30 years	
Payment Frequency	Monthly	Monthly	Monthly	
Loan Type	Amortizing	Amortizing	Amortizing	

Milton Energy & Generation Solutions Inc.

TD Bank

Facility	Project	Balance as of Dec 31, 2019
TD Facility 1: Interest bearing demand loan at prime + .95%, interest only payable monthly, principal due December 31, 2020 if not called	Fifth & Main	\$ 1,500,000
TD Facility 2: Interest bearing at prime + .85%, in blended monthly payments of \$13,469, maturing December 19, 2023	Cogeneration	\$ 2,220,083
TD Facility 3: Interest bearing demand loan at prime + 1%, interest only payable monthly, principal due December 31, 2020 if not called	Fifth & Main	\$ 500,000
TD Facility 4: Interest bearing at 3.61%, in blended monthly payments of \$16,988, maturing January 17, 2023	Solar FIT	\$ 2,596,338
TD Facility 5: Interest bearing demand loan at prime, interest only payable monthly, principal due on or before July 21, 2020 if not called – a non-revolving construction facility with a credit limit of \$10,300,000. The facility will be repaid with a committed term facility once construction is complete.	Battery	\$ 2,366,646

The loans are secured by a general security agreement over all of the company's assets, a mortgage on the land located at Fifth Line and Main Street in the amount of \$2,000,000 and guarantees by the Town of Milton in the amount of \$5,100,000.