



The Corporation of the Town of Milton

Report To: Council

From: Glen Cowan, Chief Financial Officer / Treasurer

Date: February 7, 2022

Report No: CORS-006-22

Subject: Milton Hydro Holdings Inc. Updates

Recommendation: THAT the accounting firm KPMG LLP (“KPMG”) be appointed as the external auditor for Milton Hydro Holdings Inc. and its subsidiaries for the fiscal year 2021.

THAT the \$14,934,210 in proceeds from the return of the principal balance for the promissory note to Milton Hydro be transferred to the Infrastructure Renewal - Roads, Structures and Traffic Reserve, where it can be primarily utilized to support future infrastructure investment within the community.

THAT, in order to stabilize the Town’s 2022 operating budget for any net shortfall related to interest payments or dividends from Milton Hydro, a transfer in the estimated amount of \$1,013,335 be made from the Infrastructure Renewal - Roads, Structures and Traffic Reserve to the Operating Budget.

EXECUTIVE SUMMARY

- Milton Hydro’s Board has selected KPMG LLP as the auditor for the years ending 2021 to 2025 following completion of a request for proposal process. Town Council approval is also required in accordance with the Shareholder Direction.
- Milton Hydro’s 2022 Budget and Business Plan includes the re-financing of the \$14.9 million promissory note that had been provided by the Town. This change is part of a broader strategy that is being introduced by Milton Hydro that is expected to lead to growth in the total return to the shareholder in the long term.
- A shortfall in cash flow to the Town (in the form of interest and dividend payments) is expected in the year 2022 relative to the Town’s 2022 Budget. Utilization of a portion of the principal repayment would allow for this variance to be mitigated, with the remainder of the principal repayment remaining available for future investment opportunities for the Town.
- Milton Hydro expects further updates to their long term funding strategy and dividend policy in 2022, after which the Town can further update the operating budget as part of the 2023 budget process.



REPORT

Background

Upon the incorporation Milton Hydro Holdings Inc. (“Milton Hydro”) in the year 2000, a capital financing structure was established and a Shareholders Direction was approved by Town Council. This purpose of the Shareholder Direction is to express the fundamental principles regarding the business and to set out the Board’s responsibility and relationship with the Shareholder (i.e. the Town of Milton). Town Council periodically provides updated direction to Milton Hydro, at times in the form of amendments to the Shareholder Direction. Recent updates have included debt authorization changes through CORS-025-20 and governance changes through CORS-004-20.

Topics covered through the Shareholder Direction include, but are not limited to, the appointment of an auditor, the disposal of assets, and the financial return on the Shareholder’s investment. In late 2021 the Board of Milton Hydro approved several resolutions related to these areas, and as such an update to Milton Council in advance of the next Annual General Meeting (AGM) through this report is timely.

Discussion

Section 1: Auditor Appointment

Section 5.2(f) of the Shareholder Direction relating to Milton Hydro Holdings Inc. (“Shareholder Direction”) requires Town Council approval in order to finalize the appointment of an auditor. Section 6.7(c) further indicates that appointment of the auditor would generally occur as part of the AGM. A Request for Proposal (RFP) was issued in the fall of 2021 to cover the audits of fiscal years 2021 to 2025. In order to finalize the appointment for the auditor for 2021 year end, approval of Town Council is being requested through this report in advance of the next AGM.

The RFP encompassed the annual audit statements for Milton Hydro Holdings Inc. (“MHHI”), which is comprised of the following subsidiaries: Milton Hydro Distribution Inc. (“MHDI”), Milton Energy and Generation Solutions Inc (“MEGS”), Milton Hydro Services Inc. (“MHSI”). The RFP process was undertaken on a collaborative basis with the Town of Milton, with separate evaluations and awards for each the Town and Milton Hydro. The Town of Milton previously awarded its audit services through report CORS-057-21 to Deloitte LLP.

The audit service requirements for Milton Hydro include:



Discussion

- Auditing of the consolidated annual financial statements for each year ended December 31, in accordance with generally accepted auditing standards.
- Reporting to the Board of Directors on or before April 30 of the following year, an opinion on whether or not the consolidated financial statements, which include all owned and controlled corporations, fairly present the financial position and results of operations in accordance with generally accepted accounting principles.
- Providing as part of the annual audit, advice and recommendations on the utility's management and internal control procedures.

Four proposals were received and were evaluated on the following criteria:

- Proposal costs;
- Corporate qualifications and experience;
- Audit team qualifications and experience;
- Audit services including proposed work plan; methodology tasks and services, and references received.

The successful proponent was KMPG LLP. The annual cost for audit services amounted to \$72,400 for 2021, growing to \$79,800 for the 2025 year end process.

The Board for Milton Hydro approved the appointment of KPMG LLP at its December 13, 2021 meeting.

Section 2: Refinancing of the Promissory Note

The Corporation of the Town of Milton has received 2,000 common shares in the original amount of \$17,548,467, and a promissory note in the amount of \$14,934,210 upon the reorganization of Milton Hydro-Electric Commission to Milton Hydro Holdings Inc. The note bears interest at 7.25% per annum.

Through the fall of 2021 Milton Hydro has been evaluating its financing structure, cash flow and distributions to the Shareholder as part of the development of the 2022 budget as well as its long term financial planning. In November 2021, representatives from the Town of Milton and the Business Continuance subcommittee of MHDl met to discuss the possibility of refinancing the \$14,934,210 promissory note. The Board has subsequently approved Milton Hydro's 2022 Budget and Business Plan at its meeting on December 13, 2021.

The approved plan incorporates a number of improvement initiatives that have been identified by Milton Hydro, as well as assumptions pertaining to the next regulatory rate approval process. Key financial metrics are forecasted to 2026 (examples - debt to capital ratio, debt service coverage, current ratio, return on equity, etc.), and each shows a strengthening position during the term.



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In terms of return to Shareholder, the Town receives the interest on the promissory note as well as the annual dividend from Milton Hydro. The change with respect to each relative to the previously approved Budget and Business Plan is shown below.

Table 1: Milton Hydro Payment to Shareholder Comparison (\$Millions)

	2022	2023	2024	2025	2026
MH 2021 Budget and Business Plan					
Interest on Note	\$1.08	\$1.08	\$1.08	\$1.08	\$1.08
Dividend	\$1.50	\$1.50	\$1.50	\$1.50	\$1.50
Total	\$2.58	\$2.58	\$2.58	\$2.58	\$2.58
MH 2022 Budget and Business Plan					
Interest on Note	\$0	\$0	\$0	\$0	\$0
Dividend	\$1.57	\$2.96	\$2.51	\$2.66	\$2.78
Total	\$1.57	\$2.96	\$2.51	\$2.66	\$2.78
Difference					
Total	(\$1.0)	\$0.38	(\$0.07)	\$0.08	\$0.20

As shown, after initial pressures in 2022, the re-financing and business plan changes are expected to lead to future growth in the annual cash flow that is available to the Town. In addition to the cash flows above, the Town will also generate a return on investment through the separate re-investment of the \$14.9 million principal returned through the re-financing.

Milton Hydro has secured terms to allow for the re-financing of the Town’s promissory note, and a transfer of the \$14.9 million principal to the Town occurred on January 4, 2022. One of the considerations in the evaluation has been income tax implications of the financing, and based on the terms of the new borrowing Milton Hydro will achieve pre-tax cash flow savings on the debt of \$873,651 and after tax savings of \$642,134.

The new debt held by Milton Hydro will be used for short-term capital and operating requirements. Milton Hydro will manage this re-financed debt within the debt limits approved by Town Council through report CORS-025-20. Further development of Milton Hydro’s financing strategy will occur in the first half of 2022, including an update to the dividend policy. A further update to the Shareholder can be expected at the 2022 AGM.

Section 3: Land Sale

MEGS has approved a resolution to authorize the Chief Executive Officer to negotiate and enter into a sale agreement for the land owned at Fifth and Main, subject to the terms and conditions returning to the Board of Directors for final approval once a reasonable offer is received. Management engaged a The Altus Group to provide a property appraisal of land,



Discussion

and the estimated market value as of the effective date of September 1, 2021, is \$6.1 million. The Shareholder Direction (Section 5.2(d)) only requires Town Council approval of the sale of all, or substantially all, of Milton Hydro's assets. As such, this update has been provided for information purposes only.

Financial Impact

With respect to the appointment of the auditor, the annual audit cost (which is expected to range from \$72,400 to \$79,800 for the 2021 to 2025 year ends) will be budgeted for and paid directly by Milton Hydro. Similarly any net proceeds from the sale of land (after allowing for any related transaction costs and the repayment of existing loans related to the acquisition of the lands) will be managed by Milton Hydro.

There will be implications to the Town with respect to the re-financing of the \$14.9 million promissory note as well as Milton Hydro's approved 2022 Budget and Business Plan. As noted above, the changes are expected to lead to growth in the annual revenues available to the Town, however an initial shortfall in the payments received from Milton Hydro of \$1.01 million is projected for the year 2022.

The Town's 2022 Budget incorporates \$2.58 million in dividend and interest payments from Milton Hydro. The \$1.5 million in dividends are utilized to support the Town's annual capital financing requirements. The \$1.08 million in interest on the promissory note it utilized to support the gross operating budget for Town services.

It is recommended that the \$14.9 million in proceeds from the return of the principal balance be transferred to the Infrastructure Renewal - Roads, Structures and Traffic Reserve, where it can be utilized to support future infrastructure investment within the community. As per the 2022 Approved Budget, that reserve is expected to end the year 2022 with a balance of \$19.9 million, which is significantly below the target balance that is based on the value and age of the Town's assets. It is then recommended that a transfer from that reserve to operating be made in order to stabilize the Town's 2022 operating budget for any net shortfall related to interest payments or dividends from Milton Hydro. The estimated amount of that transfer is \$1,013,335.

Following completion of Milton Hydro's further review of capital financing and dividend policy in the first half of 2022, the Town will further update the Operating Budget through the 2023 budget process to reflect the allocation of the revised dividend forecast between operating costs and capital financing.

Respectfully submitted,

Glen Cowan



The Corporation of the Town of Milton

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Chief Financial Officer / Treasurer

For questions, please contact: Glen Cowan, CFO & Treasurer Phone: Ext. 2151

Attachments

CAO Approval
Andrew M. Siltala
Chief Administrative Officer

Recognition of Traditional Lands

The Town of Milton resides on the Treaty Lands and Territory of the Mississaugas of the Credit First Nation. We also recognize the traditional territory of the Huron-Wendat and Haudenosaunee people. The Town of Milton shares this land and the responsibility for the water, food and resources. We stand as allies with the First Nations as stewards of these lands.