



Report to: General Committee

Report Date: December 2, 2013

SUBJECT: Markham Enterprises Corporation Equity Injection
PREPARED BY: Mark Visser, Manager of Financial Strategy & Investments

RECOMMENDATION:

1. That the report entitled “Markham Enterprises Corporation Equity Injection” be received;
2. And that the City of Markham subscribe for additional Markham Enterprises Corporation shares, over the next four years, up to a maximum of \$17.1 million, to facilitate a Markham Enterprises Corporation equity injection into PowerStream for their core business funding requirements, with the purchase to be funded through the City’s Lifecycle Replacement & Capital Reserve Fund;
3. And that the City of Markham’s commitment to subscribe for Markham Enterprises Corporation shares, up to a maximum of \$20.511 million, to facilitate a Markham Enterprises Corporation equity injection into PowerStream for their solar business, be extended to December 31, 2014;
4. And that the Mayor and Clerk be authorized to execute such documents as are necessary to give effect to this resolution, in a form satisfactory to the City Solicitor;
5. And that staff be directed to do all things necessary to give effect to this report.

PURPOSE:

The purpose of this report is to obtain Council approval for an equity injection into Markham Enterprises Corporation (“MEC”) to fund PowerStream’s core business, as well as authorize an equity injection extension to MEC to fund PowerStream’s Solar Photovoltaic (PV) project.

OPTIONS/ DISCUSSION:

MEC is wholly owned by the City of Markham, and MEC owns 34.185% of PowerStream and 100% of Markham District Energy. PowerStream operates at a 60:40 debt to equity ratio. On occasions when they require additional equity, PowerStream will make a request to their shareholders, including MEC, for funding. Depending upon the magnitude of the funding request, MEC may need to obtain those funds from the City of Markham in the form of a purchase of additional MEC shares.

PowerStream Core Business

PowerStream continually re-invests in its infrastructure as part of their ongoing operations. Historically, they have been able to cover this investment with retained earnings and external debt, while maintaining a 60:40 debt to equity ratio.

PowerStream has examined their financial situation as well as their forecasted infrastructure requirements and based on their 2013 budget (and consistent with what PowerStream filed with the Ontario Energy Board (OEB) as part of the Cost-of-Service Application),

PowerStream plans to spend a significant amount on capital in the 2013-2017 timeframe. This capital program is to be funded approximately at 60% debt and 40% equity. The equity that remains in PowerStream in retained earnings can partially fund the program but is not sufficient to fully fund this one time increase in capital. As such, this program will require additional external debt and \$50 million of new equity. PowerStream has approached its shareholders with a request to inject the \$50 million of equity. Markham Enterprises Corporation (MEC) owns 34.185% of PowerStream, therefore MEC's share of the equity request would be approximately \$17.1 million.

PowerStream will use these new funds supplied by the shareholders and external lenders to invest in ratable assets on which they would be able to earn an approximate 8-10% return on equity. Based on the current dividend policy, PowerStream would pay 50% of these additional profits to the shareholders, and retain the other half to reinvest in other assets.

PowerStream has indicated that the request for additional equity to fund core business infrastructure will not be a recurring issue and that there are no other viable options for PowerStream to raise equity unless the shareholders are willing to reduce their ownership in PowerStream by admitting an outside shareholder.

Staff looked at various funding options and have determined the best funding source for the equity injection is the City's Lifecycle Replacement & Capital Reserve Fund ("Lifecycle Reserve"). The City's Lifecycle Reserve is one of the Markham's most significant reserves, with a balance of approximately \$66 million (as of September, 2013). In the past, the City had invested those funds into more traditional investments such as bonds, GICs, and other money market instruments. However, in recent years, a portion of the funds have been used to fund PowerStream's Solar Business (up to \$20.5 million), a loan to Markham District Energy to build the 8100 Warden Data Centre (\$4.5 million), and the purchase of 75 Clegg Rd (\$6.5 million). The cash inflows related to these investments are all diverted back to the Lifecycle Reserve until the initial investment plus foregone interest is repaid. The key to these investments is that they do not impact the City's ability to fund the repair and replacement of assets over the next 25 years.

In evaluating whether PowerStream's request for \$17.1 million could be funded through the Lifecycle Reserve, staff compared the expected increase in dividends related to the equity investment in PowerStream with more traditional investments, such as long-term bank bonds. The analysis indicates that the returns to the Lifecycle Reserve are expected to be comparable and the investment in PowerStream would not adversely impact the City's ability to fund the repair and replacement of assets over the next 25 years. Furthermore, the equity injection would increase the value of PowerStream, of which the City, through MEC, owns 34.185%.

Therefore, it is recommended that the City of Markham subscribe for additional Markham Enterprises Corporation shares, over the next four years, up to a maximum of \$17.1 million, to facilitate a Markham Enterprises Corporation equity injection into PowerStream for their core business funding requirements, with the purchase to be funded through the City's Lifecycle Replacement & Capital Reserve Fund.

PowerStream Solar Business

In 2009, PowerStream management mobilized a team to assess the opportunities offered to Local Distribution Companies (LDCs) by the *Green Energy and Green Economy Act, 2009* in renewable generation and the Feed-in-Tariff (FIT) program, and concluded that PowerStream should invest in a portfolio of solar generation projects.

In September, 2009, PowerStream indicated that it was formulating a specific “ask” to its shareholders (Markham Enterprises Corporation (“MEC”), Vaughan, Barrie) for approval of a funding mechanism that would allow PowerStream to invest approximately \$150 million in solar generation.

The \$150 million investment by PowerStream was to be funded through external debt (\$90 million) and shareholder equity (\$60 million) in accordance with the preferred debt to equity ratio of 60:40. The shareholders contributions were to be made in proportion to their existing interest in PowerStream. MEC’s share of that equity injection was approximately \$20.511 million (34.185% of the \$60 million).

The equity injections were to be linked to PowerStream’s signing of Ontario Power Authority (OPA) FIT contracts in 2010 and 2011. Therefore MEC’s \$20.511 million of equity was to be injected in tranches over those two years as FIT contracts were approved, with the shareholder’s commitment to the equity injection to be reviewed at the end of 2011 if all the funds had not been spent.

MEC’s investment in the PowerStream solar project was to be funded by the City’s purchase of additional MEC shares. MEC would use the proceeds of the City’s share purchase to then purchase an equal dollar amount of new “Class A” non-voting shares to be issued by PowerStream.

The MEC Board of Directors approved the equity injection in December 2009. The City of Markham then approved the required equity injection from the City to MEC in June of 2010, with the following resolution:

“That the City of Markham subscribe for an additional 5,000 Common Shares of Markham Enterprises Corporation over the next two years, at a price of approximately \$20.5M, the actual price to be determined jointly by the Treasurers of the City of Markham and Markham Enterprises Corporation; the funds for this purchase to be funded from the Lifecycle Reserve.”

Although PowerStream made a significant number of FIT applications to the OPA, the popularity of the FIT program and uncertainty surrounding the October 2011 Provincial election created significant delays in the FIT contract approval process. As such, in 2011, Markham Council approved an extension for the equity funding until the end of 2013.

As of November, 2013, Markham has invested \$13.2 million of the \$20.5 million commitment. It is expected that another \$1.3 - \$2.9 million will be invested by the end of 2013.

PowerStream is submitting applications for FIT 3.0 contracts to the OPA for all potential projects with rooftop leases, which they currently have with third parties and shareholders, in the current application window (November 4th to December 13th, 2013). PowerStream would therefore like to extend its access to the remaining tranche of the \$150 million program into 2014. It is anticipated that all applications made to the OPA will be reviewed by the OPA in Q1 of 2014 with contracts being awarded most likely in Q2.

Based on the expected rate of return on the Solar PV initiative and the expected OPA contracts that PowerStream are expected to sign, it is recommended that the City agree to extend the timeline of the equity injection commitment for projects with a signed lease and viable FIT contract applications, or executed asset purchase agreement, that meet the agreed upon internal rate of return, to the end of 2014.

Based on the guaranteed FIT rate on the solar power generation, it is estimated the City will recoup its investment by 2022 in the form of increased dividends from PowerStream, with additional dividends being received until approximately 2033.

Therefore, it is recommended that the City's commitment to subscribe for Markham Enterprises Corporation shares, up to a maximum of \$20.511 million, to facilitate a Markham Enterprises Corporation equity injection into PowerStream for their solar business, be extended to December 31, 2014.

ENVIRONMENTAL CONSIDERATIONS:

Not Applicable

ACCESSIBILITY CONSIDERATIONS:

Not Applicable

BUSINESS UNITS CONSULTED AND AFFECTED:

Legal

RECOMMENDED BY:

26/11/2013

26/11/2013

X 

Joel Lustig
Treasurer

X 

Trinela Cane
Commissioner, Corporate Services