CITY OF HAMILTON

CORPORATE SERVICES DEPARTMENT
Financial Planning and Policy Division

TO: Mayor and Members General Issues Committee	**WARD(S) AFFECTED:** CITY WIDE
COMMITTEE DATE: February 14, 2011	
SUBJECT/REPORT NO: City of Hamilton Policy for Hamilton Renewable Power Inc. (HRPI) Dividends (FCS11002) (City Wide)	
SUBMITTED BY: Roberto Rossini General Manager Finance and Corporate Services	**PREPARED BY:** John Savoia (905) 546-2424, ext. 7298
SIGNATURE:	

RECOMMENDATION:

(a) That the 2009 Hamilton Renewable Power Inc. (HRPI) special dividend of $500,000, received by the City in November 2010 (originally intended to be used to offset forecast lower recycling revenues) be transferred to a dedicated Closed Landfill Reserve to be established to fund the cost of future liability costs associated with closed landfill sites;

(b) That for 2010, 75% of the $757,963 Hamilton Renewable Power Inc. (HRPI) regular dividend be transferred to the Unallocated Capital Reserve (108020) to address the City's current infrastructure deficit;

(c) That a City of Hamilton Policy for Hamilton Renewable Power Inc. (HRPI) Dividends be approved incorporating the following directions:

i) That commencing with 2010, that 25% of the Hamilton Renewable Power Inc. (HRPI) regular dividends be transferred to the Wastewater Capital Reserve (108005);

ii) That the following set amounts of $400,000 for 2011, $300,000 for 2012, $200,000 for 2013 and $100,000 for 2014 of the respective annual Hamilton Renewable Power Inc. (HRPI) regular dividend be directed to the Operations and Waste Management – recycling and waste disposal operating budget with the balance of declared dividends to be transferred to a dedicated Closed Landfill Reserve to be established;

iii) That commencing with 2015, that 50% of the Hamilton Renewable Power Inc. (HRPI) regular dividends be transferred to Unallocated Capital Reserve (108020) and 25% be transferred to a dedicated Closed Landfill Reserve to be established;

iv) That all future Hamilton Renewable Power Inc. (HRPI) special dividends received be transferred to a dedicated Closed Landfill Reserve to be established, until such time as those liabilities are eliminated, at which time, any future special dividends be transferred to the Unallocated Capital Reserve (108020).

EXECUTIVE SUMMARY

During the 2010 tax-supported budget deliberations, direction was provided to staff to develop a dividend policy for Council to consider for the distribution of dividend payments from the City's wholly-owned, Hamilton Renewable Power Inc. (HRPI).

HRPI, established in 2005, owns and operates two renewable power generation facilities in Hamilton that have already demonstrated economic and environmental successes. Both facilities not only generate renewable electricity but also significantly reduce greenhouse gas emissions. The Board of Directors for HRPI has approved a dividend policy to distribute available earnings and cash flow to the City as its sole shareholder under certain conditions:

- Regular Dividends – at a target dividend payment rate of 80% of annual net earnings, based on the audited financial statements;

- Special Dividends – periodic payments will be made from excess retained earnings not required to maintain a positive cash flow.

Prior to 2009, HRPI's operating results and financial position did not meet the above conditions to allow for any dividends to be declared. For 2009 and 2010, dividends have been declared and HRPI has forecast that it expects to distribute regular dividends over the next four years, as detailed below, in Table 1 to report FCS11002:

TABLE 1

	Hamilton Renewable Power Inc. Dividends					
	2009 Act	**2010 Act**	**2011 Fcst**	**2012 Fcst**	**2013 Fcst**	**2014 Fcst**
Regular	$ -	$ 757,963	$ 767,414	$ 736,312	$ 752,085	$ 768,565
Special	500,000	-				
Total	**$ 500,000**	**$ 757,963**	**$ 767,414**	**$ 736,312**	**$ 752,085**	**$ 768,565**

In September 2010, HRPI declared a special dividend of $500,000 based on its 2009 year-end financial position with the dividend proceeds received by the City in November 2010. As part of the 2010 tax-supported budget process, Council directed that the special dividend be allocated in its entirety to the Waste Management operating budget in order to partially off-set expected lower recycling revenues. As a result, direction was provided to staff to develop a dividend policy for the City regarding future revenues from HRPI. Staff have chosen to develop this Policy under the guiding principle of financial sustainability that promotes a forward-looking approach to leverage limited resources.

The recommended City of Hamilton Policy for Hamilton Renewable Power Inc. (HRPI) Dividends (Policy) is premised on the City's Strategic Plan focus area of financial sustainability with the specific goals to promote a financially sustainable City by 2020 and to address infrastructure deficiencies, identified at approximately $195 million annually.

A key aspect of the Policy is to recognize that, since Ontario's electricity industry operates in a regulated environment, regulatory changes can affect rate structures and profitability. Accordingly, staff recommend that HRPI dividend revenue not be considered a permanent source of revenue. Therefore, staff recommend that over the longer term HRPI dividend revenue should be committed only to those capital projects that could be deferred should funding be unavailable. On a permanent basis, applying such extraordinary revenue sources against City programs and services may create funding pressures on occasion.

The City owns and operates one open landfill site while it owns and maintains twelve closed landfill sites. The active landfill site in the Glanbrook community is estimated to reach its capacity and close in approximately 30 years time. The closure costs for the open landfill site and post-closure care costs for the closed sites have associated future liability costs. Studies continue to be undertaken to assess the liability associated with closed landfill sites with a liability value of $26,952,000 carried on the City's financial statements as of December 31, 2009. As there currently is no funding source for this future liability, staff recommend that a portion of HRPI regular and special dividend revenues be a funding source that is directed to a reserve to assist in defraying these future costs.

Alternatives for Consideration – Refer to pages 8 - 9

FINANCIAL / STAFFING / LEGAL IMPLICATIONS (for Recommendation(s) only)

Financial: The adoption of the proposed Policy will provide some financial support to the Operations and Waste Management – recycling and waste disposal operating budget on a declining scale until 2015 when the HRPI dividend support to this operating budget is entirely phased-out. The limited direction of future HRPI dividends to the Waste Management operating budget will occur until 2014 and beyond 2015, HRPI dividends will be transferred to capital projects such that, should the dividend revenues not be available, the projects may be deferred without jeopardizing the long-term sustainability of ongoing City programs and services.

Staffing: None.

Legal: None.

HISTORICAL BACKGROUND (Chronology of events)

In 2005, the City of Hamilton created Hamilton Renewable Power Inc. (HRPI). Inception of this company came out of the City's desire to construct, operate and maintain a co-generation facility as a source for renewable energy. Under the legislation, in effect at that time, the City was not able to directly participate in this venture. Therefore, a City-owned corporation, Hamilton Renewable Power Inc. (HRPI), was established to carry out the construction, operation and maintenance of this renewable energy facility.

Hamilton was the first municipality in Ontario to be accepted by the Ontario Energy Financial Corporation to build a generator for sustainable green energy. The first co-generation facility opened in 2006, at Hamilton's Wastewater Treatment Plant, takes methane gas to produce electricity and heat. A second facility, which opened in 2008 at the Glanbrook Landfill, collects landfill gas to generate electricity which is sold to the Ontario grid. Both facilities, not only generate renewable electricity, but also significantly reduce greenhouse gas emissions.

The Board of Directors for HRPI has approved a dividend policy to distribute available earnings and cash flow to the City as its sole shareholder under certain conditions:

- Regular Dividends – at a target dividend payment rate of 80% of annual net earnings, based on the audited financial statements;

- Special Dividends – periodic payments will be made from excess retained earnings not required to maintain a positive cash flow.

As presented in Table 2 to report FCS11002, prior to 2009, HRPI's operating results and financial position did not meet the above conditions to allow for any dividends to be declared. It should be noted that HRPI does carry significant unsecured capital loans, bearing interest at 6.75% maturing in 2019 that are payable to the City with a current outstanding balance of approximately $5.1 million.

TABLE 2

Hamilton Renewable Power Inc. Profit/(Loss) Performance					
2004	2005	2006	2007	2008	2009
$ (66,466)	$ (209,476)	$ (218,363)	$ 184,301	$ (28,544)	$ 834,850

HRPI has matured from a start-up company that, following an initial special dividend declared in September 2010, it has forecast that it expects to distribute regular dividends, over the next four years, as outlined in Table 1 of report FCS11002.

In September 2010, HRPI declared a special dividend of $500,000 based on its 2009 year-end financial position with the dividend proceeds received by the City in November 2010. As part of the 2010 tax-supported budget process, Council directed that the special dividend be allocated in its entirety to the Waste Management operating budget in order to partially off-set expected lower recycling revenues. A positive rebound in recycling revenues has occurred in 2010, resulting in recommendation (a) of report FCS11002 requesting Council's approval to redirect the $500,000 special dividend proceeds to a dedicated Closed Landfill Reserve to be established to initiate a funding source to address significant unfunded liabilities associated with closed landfills as described in the Executive Summary section of this report.

Direction was provided to staff to develop a dividend policy regarding future revenues from HRPI and staff have chosen to develop this Policy under the guiding principle of financial sustainability. Report FCS11002's recommendations seek approval for the distribution of the HRPI declared regular dividend of $757,963 received by the City in November 2010 and to provide specific direction of the regular and special dividends thereafter.

POLICY IMPLICATIONS

The Hamilton Renewable Power Inc. Dividend Policy provides specific policy commitments in alignment with the City's Strategic Plan focus area of financial sustainability noted above.

RELEVANT CONSULTATION

Public Works Department - Operations and Waste Management Division and the Transportation, Energy and Facilities Division.

ANALYSIS / RATIONALE FOR RECOMMENDATION

(include Performance Measurement/Benchmarking Data, if applicable)

As part of the process in developing a Hamilton Renewable Power Inc. Dividend Policy (Policy), staff conducted a literature review. The review established that a number of Canadian municipalities have approved dividend policies directing dividends from municipally-owned utility entities to capital infrastructure with the following examples:

- **City of Calgary** – Council adopted a dividend policy in 2002, regarding municipally-owned Enmax Corporation's electricity and natural gas profits whereby a significant portion of dividends are transferred to capital reserves. Enmax pays dividends to the City of Calgary, annually, based on the greater of $30 million or 30% of the prior year's net earnings. In 2003, Calgary established their *Legacy Parks* program to create and upgrade public park space with $50 million over an initial five-year period funded from the annual Enmax dividend. In 2008, the *Legacy Parks* program was extended for another five years when Council dedicated another $75 million to the program.

- **City of Edmonton** - The City of Edmonton's natural gas, power and water utilities merged in 1996 to form EPCOR Utilities which is 100% owned by the City of Edmonton. In June 2009, Council approved that all EPCOR dividends be utilized as the primary funding source for the general Capital Budget. The related staff report to Council noted: "it is easier to deal with variable ups and downs of investment and dividend earnings in the Capital Budget by accelerating or deferring one-time capital projects than it is to reduce ongoing programs and services in the Operating Budget."

- **City of Thunder Bay** – In January 2010, Council approved a new dividend policy for its wholly-owned telecommunications company, TBay Tel that introduced a special dividend component to its existing dividend policy. The "performance dividend" will result from excess retained earnings as determined by TBay Tel's Board of Directors. Under this new policy, any such performance dividends will be directed to the Renew Thunder Bay Reserve Fund; a Council approved five-year incremental capital plan to enhance local quality of life and to invest in targeted, highly leveraged strategic infrastructure investments to grow the local economy.

- **City of Hamilton – Horizon Utilities Corporation (HUC)** – HUC's dividend policy is predicated upon maximizing shareholders value with Hamilton Utilities Corporation and St. Catharines Hydro Inc. being its two shareholders. HUC declares and pays dividends from available earnings and cash flow, subject to certain conditions outlined as:

  - Regular Dividends – at a target dividend payment rate of 60% of audited annual net earnings;

  - Special Dividends – periodic payments will be made to maintain the approved capital structure of HUC.

  The City of Hamilton has historically utilized HUC regular dividends to support both the operating budget (approximately $5 to $8 million annually) and the capital budget (approximately $2 million annually). With respect to HUC special dividends, the City has, in the past, chosen to utilize such extraordinary revenues to support capital uses, e.g., in 2007, when the City received $10 million as a special dividend from the sale of Hamilton Fibrewire, the entire amount was allocated to capital.

Based on this review, the recommended Policy recognizes that Hamilton Renewable Power Inc. is a valuable asset to the City and should be utilized to maximize its value to both the City and taxpayers by returning the interest and dividends to help finance the City's capital program. Using HRPI dividends to support City services and programs, normally funded by the tax levy and/or user fees, may not be sustainable due to the inherent fluctuations in dividends from operations in the highly regulated Ontario energy market.

Recommendation (b) subsection iii) does provide for HRPI regular dividends to provide some support to the Operations and Waste Management - recycling & waste disposal operating budget over the 2011-2014 time frame. It is recommended that set amounts of $400,000 for 2011, $300,000 for 2012, $200,000 for 2013 and $100,000 for 2014 of the HRPI regular dividend be directed to the waste disposal operating budget to offset pressures that are a result of HST, CPI adjustment factors and incentive costs for increased waste compaction that are included under the current landfill operating contract between the City and Waste Management of Canada Corporation (WMCC).

The estimated replacement value of the City's active landfill in Glanbrook is $150 million. To preserve landfill life, a comprehensive waste diversion program is already in place, however an additional cost effective method of increasing landfill life is to increase the amount of waste placed in a given volume of space, and this is commonly referred to as landfill compaction. In an audit conducted by Audit Services in 2007 on the contract between the City and WMCC, it was recommended that best practices be incorporated into any upcoming landfill contracts to ensure that current standards are in place. As a result, the required compaction rates and compensation relating to them were reviewed and updated in the current contract with WMCC.

Landfill capacity is measured in both tonnes and volume of airspace, with landfill compaction being measured in kilograms per cubic metre (kg/m^3). The WMCC contract requires that the compaction rate be a minimum of 750 kg/m^3. The contract contains an incentive to WMCC if the compaction rate exceeds 800 kg/m^3 and includes liquidated damages should the compaction rate fall below 750 kg/m^3. The expected recycling and waste disposal operating budget pressures that HRPI regular dividends will help to defray are based on compaction incentive experience with WMCC in 2010 which is the first year of the ten year contract. Analysis has shown that there is a positive long term benefit in view of the increased compaction contract costs by extending the capacity of the existing landfill (refer to Report PW08123(a)/FCS08101(a)). By increasing the required compaction rate from 600 kg/m^3 in the old contract to 800 kg/m^3 in the new contract with incentive, it is estimated that 1.25 years of landfill life will be gained and that this capacity has a value of $11,190,000 over the term of the contract or $1,119,000 per year. Therefore the benefits in gained capacity and value at the landfill outweigh the costs in compaction incentives.

The City owns and operates one open landfill site while it owns and maintains twelve closed landfill sites. The active landfill site in the Glanbrook community is estimated to reach its capacity and close in approximately 30 years time. The closure costs for the open landfill site and post-closure care costs for the closed sites have associated future liability costs. Studies continue to be undertaken to assess the liability associated with closed landfill sites with a liability value of $26,952,000 carried on the City's financial statements as of December 31, 2009. As there currently is no funding source for this future liability, recommendations to report FCS11002 include initiating a dedicated Closed Landfill reserve to assist in defraying these future costs that HRPI regular and special dividend proceeds would be directed to.

ALTERNATIVES FOR CONSIDERATION:

(include Financial, Staffing, Legal and Policy Implications and pros and cons for each alternative)

Alternative – HRPI regular dividend allocation directed 100% to Tax Operating Budget

Option would be to provide all HRPI regular dividend distributions to support the Tax Operating Budget. Recommendation (b) iii) to Report FCS11002 would still be the recommended approach for any HRPI special dividend distribution.

Implications:

- would direct all HRPI regular dividend distributions to the tax operating budget thereby alleviating some future levy tax pressures
- potential risk that should future regular dividend revenues not be available, the long-term sustainability of City programs and services that are being funded in part by the dividends could be jeopardized. As such, this alternative is not recommended.

CORPORATE STRATEGIC PLAN (Linkage to Desired End Results)

Focus Areas: 1. Skilled, Innovative and Respectful Organization, 2. Financial Sustainability, 3. Intergovernmental Relationships, 4. Growing Our Economy, 5. Social Development, 6. Environmental Stewardship, 7. Healthy Community

Financial Sustainability

- Financially Sustainable City by 2020
- Delivery of municipal services and management capital assets/liabilities in a sustainable, innovative and cost effective manner
- Address infrastructure deficiencies and unfunded liabilities

APPENDICES / SCHEDULES

Not applicable.