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# HALDIMAND COUNTY

## Report FIN-16-2023 Hydro Legacy Fund Policy Review

For Consideration by Council in Committee on October 10, 2023

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### OBJECTIVE:

To review and approve proposed changes to the Hydro Legacy Fund Policy.

### RECOMMENDATIONS:

1. THAT Report FIN-16-2023 Hydro Legacy Fund Policy Review be received;
2. AND THAT going forward, the litigation allowance included in the Hydro Legacy Fund be rolled into the principal protected balance, with any future litigation to be drawn from this balance;
3. AND THAT the principal balance of the fund be indexed annually by the Statistics Canada Consumer Price Index by Product Group, monthly (February), percentage change, not seasonally adjusted, Canada, Ontario, All-Items, to a maximum of 2%;
4. AND THAT indexing of the principal balance be applied retroactively to all years since the inception of the Hydro Legacy Fund;
5. AND THAT the amended Hydro Legacy Fund Policy 2018-01, included as Attachment 1 to Report FIN-16-2023, be approved.

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**Reviewed by:** Teri Trewolla, CPA, Treasurer

**Respectfully submitted:** Mark Merritt, CPA, CA, General Manager of Financial & Data Services

**Approved:** Cathy Case, Chief Administrative Officer

### EXECUTIVE SUMMARY:

The Hydro Legacy Fund Policy (Policy) was approved by Council in 2018 in order to govern the management, uses, controls, transparency and accountability related to the Hydro Legacy Fund (Fund). One key deliverable of the Policy was intended to protect the principal value of the sale proceeds through annual indexing under specific parameters. Since the inception of the Policy staff have been monitoring and reporting on the Fund and have discovered that the indexing methodology originally approved in the Policy was not achieving the intended results. The indexing applied to the Principal Protected Balance of the Fund as a result of the requirements in the Policy allocated all realized earnings to the principal, leaving no interest available for the uses outlined in the Policy. As such, in 2022, staff committed to reviewing the Policy in 2023 and bringing back revisions to the indexing methodology in order to ensure the underlying principles pertaining to the Policy were maintained.

Staff are recommending that the index utilized to index the principal protected balance be updated to the Statistics Canada Consumer Price Index by Product Group, monthly (February), percentage change, not seasonally adjusted, Canada, Ontario, All-Items (Table: 18-10-0004-13), to a maximum of 2%. This will help achieve the underlying goal of protecting the Principal Balance, as well as ensuring

there are interest earnings available for use under the terms of the Policy. Retroactively applying this change in methodology will ensure consistent application and clearer reporting.

It will be necessary in the future to review the continued requirement of indexing the principal. As the Principal Protected Balance cannot be utilized, it would continue to grow in perpetuity should this parameter not be revisited.

The Policy also currently contains a litigation allowance which does not form part of the principal protected balance (originally \$7 million, with an ending balance of \$6.8 million as of December 31, 2022). The litigation allowance has not been utilized since 2019, and staff are confident that no further funds will be required to allocate to activities related to litigation. Under the terms of the Policy, if it is deemed that no further litigation is expected, the remaining allowance may be reallocated to the principal protected balance and indexed from that point forward. This must be authorized by Council through the passing of a resolution, which has been included in this report.

By adjusting the indexing methodology utilized to index the principal protected balance and by reallocating the remaining litigation allowance to the protected balance, the ending principal protected balance as at December 31, 2022 reduced from \$86 million to \$80 million. The change in indexing also increases the uncommitted interest earnings balance as at December 31, 2022 from \$0 to \$14 million.

Staff also commit to reviewing the Policy with each new term of Council to ensure that the Policy and its principles and methodologies are working as intended. If further changes are recommended, follow up will proceed as directed under the terms of the Policy.

## **BACKGROUND:**

In 2015, Haldimand County sold all ownership shares in Haldimand County Hydro Utilities Inc. (HCU) to Hydro One Network Inc. (Hydro One) for net cash proceeds of \$73.3 million. After accounting for divestiture costs associated with this transaction, net sale proceeds of \$72.4 million were realized and contributed to a Hydro Divestiture Reserve Fund (later renamed the Hydro Legacy Reserve Fund).

In order to govern the management, uses, controls, transparency and accountability related to this Fund, the Hydro Legacy Fund Policy was introduced in 2018 in order to protect the fund for perpetual benefit to Haldimand County taxpayers. Through the Policy, the principal value of the sale proceeds were determined to be indexed under specific parameters in order to protect the purchasing power of the transaction over time.

At the time of Policy development it was determined that the Statistics Canada Quarterly (4<sup>th</sup>) Consumer Price Statistics, Non-residential Index for the Institutional Building category in the Toronto area be utilized to index the protected principal. This is the same inflation factor as used to index the County's development charges on an annual basis. This index was chosen primarily for consistency purposes. However, over time, it was determined that this index was not appropriate as it pertained to cost increases related to specific construction costs, and was not reflecting the intended purpose of protecting the fund for perpetual benefit of Haldimand County taxpayers. As this index increased significantly as inflation rose in recent years, it has eroded the available interest applied to the Hydro Legacy Fund. As such, it was deemed necessary through the 2021 Investment Status report (FIN-06-2022) to revisit the indexing principles within the Policy in 2023.

Furthermore, when negotiating the Share Purchase Agreement with Hydro One, the sale price was increased by \$7 million in the exchange an indemnification provision related to unknown liabilities as at the date of closing of the transactions. These funds were to be held separately from the principal protected balance and were not to be indexed. If the allowance was deemed no longer required, the Policy allowed for the surplus funds to be reallocated to the principal protected proceeds, to be indexed from that point forward. Per the Policy, in order for this to take place, a resolution would need to be

passed by Council. There has been no activity requiring the use of the allowance since the completion of a CRA Income Tax audit of the file back in 2019, and no further litigation is anticipated.

As the result of the above noted items, staff are revisiting these specific items in the Policy at time. The Hydro Legacy Policy stages that:

*“if, at any time, Council wishes to amend or override a provision of this Policy and/or the related By-law, such decision can only be considered at a Public Meeting, open to input from the public without the requirement of registering as a Delegation. In addition, the municipality will be required to provide Public Notice, at least four weeks in advance of such a meeting, and include details of the proposed motion to be voted on.”*

In order to proceed with reviewing the principles related to indexing the principle and the allocation of the litigation allowance with the Policy, staff are presenting proposed changes at the October 10<sup>th</sup>, 2023 Council in Committee meeting. Public notice has been provided in compliance with the terms of the Policy.

## **ANALYSIS:**

As a result of the internal staff review of the Hydro Legacy Policy, staff are bringing forward the following for Council and the Public's consideration:

- Changing the index used to calculate the index applied to the principal protected balance (both on a go-forward basis and retroactively)
- Rolling the remaining litigation allowance in to the principal
- Setting parameters for “check-ins” on continued relevance and appropriateness of the principals within the Hydro Legacy Fund

### **Principal Protected Balance Indexing**

Under the existing terms of the Policy, the principal protected balance is currently indexed using the Statistics Canada Quarterly (4<sup>th</sup>) Construction Price Statistics, Non-residential Index for the Institutional Building category in the Toronto area. This index was chosen at the time of Policy development for consistency purposes, as it is the same rate that is applied for annual Development Charges fee increases. Staff have witnessed over time that this index is not appropriate for the purpose of the Policy. The existing index measures the changes in what developers would pay contractors to build a representative office building, shopping centre, school, light factory or warehouse. This index is very specific, and not indicative of what the underlying principle for indexing the protected balance of the fund was intended to accomplish. The Policy was created to protect the principal for perpetual benefit to Haldimand County taxpayers. The Policy is also intended to provide parameters for use of interest earnings towards the cost of major assets/infrastructure, as outlined in section 3.d)(ii). Though the use of the fund is not part of the revisions being proposed today, by using the current index to protect the principal, all of the available interest has been eroded and therefore unable to be utilized as intended.

Staff have identified a general index that is more appropriate for the purpose of protecting the principal. It is proposed that the Statistics Canada Consumer Price Index by Product group, monthly (February), percentage change, not seasonally adjusted, Canada, Ontario, All-Items (Table 18-10-004-13) be utilized going forward. It is also recommended to adjust the index retroactively since the inception of the Hydro Legacy Fund in order to correct the principal protected amount over the life of the Hydro Legacy Fund.

Given that significant swings can occur regardless of the index chosen, staff are proposing that the annual index be capped at 2% which aligns with the overall inflationary index of the Bank of Canada.

Though not the topic of the Policy discussions at this time, it will be necessary to review the need to index the principal in the future. As this protected balance continues to grow but can not be accessed, putting a cap on the principal protected balance is recommended at some point in the future.

#### Litigation Allowance

At the time of Policy development, the sale price of HCUI was increased by \$7 million in exchange for an indemnification provision related to unknown liabilities as at the date of closing of the transactions. As significant time has now passed, staff are confident that there will be no further litigation activities. Therefore, staff are recommending that the net remaining litigation funds, which have historically been reported separately from the principal protected balance, be added to the protected balance and therefore indexed on a go-forward basis (or until it is determined that indexing the principal is no longer required).

If, by chance, although it is not anticipated at this time, litigation does arise pertaining to the Hydro Legacy Fund, staff propose that any related costs be taken from the principal protected balance.

If this change is approved, the litigation allowance will be combined within the principal protected balance both historical and going forward on the annual statement, for ease of reporting.

#### Going Forward

Given the political nature of the Policy, with each term of Council, staff commit to review the Policy with the incoming Council members to ensure the Policy and Fund, as well as their underlying principles and uses, are understood by all. If subsequent revisions to the Policy are deemed necessary, staff will follow the communication protocols outlined within the Policy.

Proposed changes to the Hydro Legacy Fund Policy 2018-01 can be found in Attachment 1.

### **FINANCIAL/LEGAL IMPLICATIONS:**

By adjusting the indexing methodology utilized to index the principal protected balance and by reallocating the remaining litigation allowance to the protected balance, the ending principal protected balance as at December 31, 2022 reduced from \$86 million (excluding the litigation balance) to \$80 million. The overall principal protected balance, with the litigation balance rolled in, went from \$93.7 million to approximately \$80 million.

The change in indexing increases the uncommitted interest earnings balance as at December 31, 2022 from \$0 to \$14 million. The overall balance of the fund, being \$93.7 million at the end of 2022, remains unchanged.

The revised Hydro Legacy Fund Statement can be found in Attachment 2.

### **STAKEHOLDER IMPACTS:**

The Hydro Legacy Fund Policy was created to protect the fund for perpetual benefit to Haldimand County taxpayers. The changes proposed within this report will enable for the Policy to continue to act as intended.

## **REPORT IMPACTS:**

Agreement: No

By-law: No

Budget Amendment: No

Policy: Yes

## **REFERENCES:**

1. [Hydro Legacy Fund Policy 2018-01](#)
2. [Notice of Public Meeting: Hydro Legacy Fund Policy Review](#)

## **ATTACHMENTS:**

1. Hydro Legacy Fund Policy 2018-01 amendments
2. Amended Hydro Legacy Fund Statement