



POLICY No. 2018-01

Hydro Legacy Fund

Originating Department Corporate Services (CS-GM-02-2018)

SMT Approval: N/A

Council in Committee: 2018-03-27

Recommendation #: 29

Council Approval: 2018-04-03

Resolution #: 45-18

Revision History:

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1. EXECUTIVE SUMMARY:

Effective June 30, 2015, Haldimand County sold all ownership shares in Haldimand County Utilities Inc. (HCUI) 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 (to be renamed the Hydro Legacy Reserve Fund). For the purpose of this policy, the inception date of the Hydro Legacy Fund is deemed to be July 1, 2015.

It is necessary to have a policy that governs the management, uses, controls, transparency and accountability measures related to this significant legacy in order to protect the fund for the perpetual benefit of Haldimand County taxpayers. The principal value of the sale proceeds will be indexed, through allocation of a portion of the investment earnings, in order to protect the purchasing power of this transaction over time. To support this indexing, as well as to generate additional investment earnings that can finance future County initiatives in perpetuity, a long term investment strategy will be necessary.

2. PURPOSE:

The purpose of this Policy is to:

- outline roles and responsibilities with regards to governing and managing the Hydro Legacy Fund, with the goal of preserving and protecting the fund in perpetuity;
- confirm the long term investment strategy, which is aimed at maximizing the return within the legislated limits and in accordance with Haldimand County's Investment Policy;

- approve the method of recording investment earnings which accrue to the Hydro Legacy Funds, given the timing difference between realized and unrealized gains/losses;
- provide direction for use of investment earnings, on a priority basis, as approved by Council, preferably during the annual budget approval process;
- clarify treatment of the litigation allowance set aside due to the indemnification of Hydro One for certain potential liabilities; and
- outline reporting requirements for ensuring public accountability, transparency and awareness of the activities transacted through the Hydro Legacy Fund on a regular basis.

3. FUNCTIONALITY:

This Policy outlines the required functionality of the Hydro Legacy Fund with respect to:

- a) Governance and Management;
- b) Investment Strategy & Earnings Approach;
- c) Use of Investment Earnings;
- d) Litigation Allowance; and
- e) Reporting Requirements

as described in detail below.

a) Governance and Management

Haldimand County Council has the fiduciary responsibility to ensure that all aspects of the Hydro Legacy Fund are governed and managed in accordance with this Policy. In particular, the obligation to protect the principal proceeds received from the sale of HCUI is paramount. Further, to ensure the purchasing power of the sale proceeds is not eroded over time, it is recognized that the first priority for allocation of any investment earnings is for the purpose of indexing the principal sum ~~(net of a litigation allowance)~~ on an annual basis. Any secondary uses of the annual investment earnings will require approval via a resolution of Council and shall meet the criteria outlined in this Policy.

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.

The Treasurer will be responsible for monitoring compliance with all aspects of this Policy.

b) Investment Strategy & Earnings Approach:

All investment activities related to these funds shall be governed by the *Municipal Act, 2001* and Haldimand County's Cash Management and Investments Policy No. 2001-11 ("Investment Policy"), both as amended, with advice from professional investment managers. Preservation of the principal sum is the primary objective of the investment program. Accordingly, investments shall be undertaken in a manner that seeks to minimize the risk to capital in the overall portfolio.

A secondary investment objective is to maximize the rate of return earned on the invested funds, within the legislated parameters and through a diversified strategy. Accordingly, the consolidated investment portfolio, as per the Investment Policy, is structured so as to maintain reasonable liquidity (ease in converting to cash), minimize risk and manage interest rate fluctuations. This prudent approach will avoid the need to sell securities at inopportune times on the open market. Despite that, there is interest rate risk associated with declines or rises in current market interest rates which can cause an investment to increase or decrease in value. Typically, downturns in annual return rates are of a short term nature, depending on the nature of the investment vehicle. Haldimand County's investment strategy should mitigate any such losses in value based on the longer term approach and with varying maturity dates.

In addition to the Investment Strategy outlined above, as part of the County's consolidated approach to cash flow management and fiscal responsibility, there may be an opportunity to utilize some of the funds to internally finance capital projects in place of external debt. Such a recommendation will be presented by the Treasurer, on a case by case basis, with a full analysis of the implications of such an approach, and will require Council approval.

Recording Investment Earnings:

As a substantial portion of the invested funds will not generate income until maturity or sold, it is important to recognize changes in value over the life of the investment. Realized and unrealized gains or losses, based on the difference between the cost (book) and market value (current market price) of securities at any point in time, will be tracked by the County's external Investment Manager, then confirmed and reported by the Treasurer to the Investment Committee (as identified in Section 7.0 of the Investment Policy) on a regular basis.

Based on this information, expected earnings can be projected for the purpose of recognizing annual investment income in the Hydro Legacy Reserve Fund, as follows:

- (i) Accruing market yields for unrealized gains:
 - An average weighted yield to maturity will be determined annually, by the Investment Advisory Committee, based on advice from the external Investment Manager on the performance to date of the overall investment portfolio and expected future market conditions.
 - The actual market earnings to date, as well as the average weighted yield expected to maturity, will be reported to Council through the Treasurer's annual Investment Report.

- Based on this information, a benchmark earnings rate will be recommended for Council's approval for the purpose of accruing unrealized earnings to the Hydro Legacy Reserve Fund.
 - Such accrual of expected market yields, based on the Council approved benchmark earnings rate, will be recorded as Hydro Legacy Fund projected investment income on an annual basis.
 - The offsetting accrual of such expected yield will be reflected in the Investment Income Stabilization Reserve. It can be expected that there will be significant differences, on an annual basis, between the accrued and released gains, depending on when investments mature or are cashed in. This reserve will help mitigate the annual investment income cash flow fluctuations caused by market volatility and redemptions.
- (ii) Reconciliation of realized gains/losses versus benchmark yield:
- When investments mature or are sold, a reconciliation between the accrued market earnings using the benchmark yield and the actual realized gains/losses will be performed.
 - Any difference in the actual yield (realized) vs the accrued earnings (unrealized), based on the Hydro Legacy Fund's proportional share of the overall investment portfolio, will be shown as an adjustment to the actual investment income allocated to this Fund, in accordance with a reconciliation process to be outlined in the Investment Policy.
 - Such reconciled amount will be reported to Council through the Treasurer's annual Investment Report.
- (iii) Reporting of Investment Earnings on Hydro Legacy Fund:
- All financial reporting related to the Hydro Legacy Reserve Fund shall clearly delineate between, and record on separate lines, the accrued investment earnings (based on the benchmark market yield for unrealized gains) and the reconciled actual investment earnings (based on realized gains/losses).

c) Use of Investment Earnings

Based on the above approach to recognize market gains in the Hydro Legacy Fund's share of the investment portfolio, prior to actual receipt of any realized cash gains, there will be accrued investment earnings available to supplement actual income on an annual basis. It will be important, however, to not overcommit through use of unrealized earnings, in order to protect the perpetual integrity of this fund. All uses of any portion of the annual investment earnings accruing to the Hydro Legacy Fund must be approved by Council, preferably during the annual budget approval process.

Taking the above into account, the following uses of the Hydro Legacy Fund investment earnings have been determined as eligible for consideration, in priority order:

(i) Annual indexing of ~~\$65.4 million of~~ the principal net sale proceeds:

- Principal value to be indexed equates to the net cash proceeds ~~of \$73.3 million, less divestiture costs of \$0.9 million, and excluding the \$7 million litigation allowance related to indemnification provisions as per the Share Purchase Agreement (refer to paragraph 3(d) below), excluding the net litigation amount until the remaining litigation allowance is to be rolled in to the principal balance, as outlined in Section 3.d).~~
- ~~Index~~Inflate the protected principal balance ~~(based on an initial value of \$65.4 million)~~ annually by the percentage change during the preceding year, as recorded in the ~~Statistics Canada Quarterly (4th) Construction Price Statistics, Non-residential Index~~ 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%. for the Institutional Building category in the Toronto area. (This is the same inflation factor as used to index the County's development charges on an annual basis.)
- This indexing will protect the ~~purchasing power present value of the~~ of the net original principal sale proceeds over time.

(ii) Contribute an amount towards the cost of major assets/infrastructure that benefit Haldimand County, not to exceed 60% of the prior year's net investment earnings (realized and unrealized), after deducting the sum first needed for inflation protection as outlined above.

- The contribution may be made to a reserve intended specifically to finance a major capital project(s) or assist in offsetting the costs (capital or operational) of a major asset which is deemed to provide County-wide benefit.
- The major capital project, as well as the specific use of funding (in whole or in part) which originally flowed from the Hydro Legacy Reserve Fund, must be explicitly approved by Council, preferably through the annual budget process.
- It is not necessary for the related capital expenditure to be made in the same year as the contribution to a reserve. It may be necessary to contribute a sum over a long period of time to build sufficient funds to upfront finance the expenditure on a "pay-as-you-go" basis. Alternatively, funds may be contributed to a reserve to subsequently pay off related long term debt charges on a specific capital project (sinking fund approach.)
- The amount of the transfer to an applicable reserve will be determined annually, and specifically approved by Council resolution.
- A transfer cannot be approved, in any given year, if it would cause a net negative investment earnings return to be reflected in the Hydro Legacy Reserve Fund or if it exceeds the 60% cap noted above.
- Acknowledgement that a project was financed, in whole or in part, from the Hydro Legacy Fund must be publicly recognized through signage and/or other

appropriate promotional efforts.

- (iii) Contribute an annual amount to reduce the operating tax levy, not to exceed the current contribution of \$300,000 approved in 2017.
 - Any consideration of increasing this annual contribution to reduce a future year's operating levy requirement should be avoided given the overall intent of the Hydro Legacy Fund is for long term benefits to Haldimand County (typically capital in nature, not operating) and other means of mitigating operational costs should be first pursued in order to provide tax relief.
- (iv) Any remaining portion of accrued investment earnings will be identified for potential future use in financing a strategic economic initiative/opportunity which is anticipated to have County wide benefits through enhancements to local employment opportunities, revenue generation and/or Haldimand's assessment base. In such a case, a public vetting of the proposal is required through a full business case study showing the projected return on the County's investment.

d) Litigation Allowance

When negotiating the Share Purchase Agreement with Hydro One, the sale price was increased by \$7 million in exchange for an indemnification provision related to unknown liabilities as at the date of closing of the transaction. Council decided to earmark the entire \$7 million as a "Litigation Allowance", with the funds to be held as such in the Hydro Legacy Reserve Fund. The following processes relate to this Litigation Allowance:

- any claim against Haldimand County related to HCUI, for which Hydro One claims the indemnification provisions apply, will be reported to Council, with legal advice as required;
- Council approved claims costs that relate to this indemnification provision will be funded from the Litigation Allowance component of the Hydro Legacy Fund and clearly reported as such;
- the available balance of the Litigation Allowance, at any given time, will not be indexed for inflationary purposes; ~~and~~
- in the event there are surplus funds deemed to be available within the Litigation Allowance, a Council resolution will approve the reallocation of these monies to the principal protected proceeds from the sale and be indexed from that point forward-;
- it was determined that surplus funds were available within the Litigation Allowance, and on October 16th, 2023, Council passed a resolution to reallocate the remaining litigation balance to the principal protected proceeds from the sale to be indexed from that point forward; and
- in the event that there are future litigation claims against Haldimand County related to HCUI they are to be funded from the principal protected balance.

e) Reporting Requirements

The Treasurer shall report to Council, at least annually, on the financial position of the Hydro Legacy Fund. Such report shall:

- review the investment performance and earnings related to this Fund, including market versus realized gains/losses, as well as reconciliation of actual to accrued earnings from prior periods;
- outline the recommended benchmark market interest rate for accruing of investment income to this Fund for the coming year;
- provide an accounting of all transactions, with specific details, affecting this Fund;
- outline any transactions affecting the litigation allowance (originally set at \$7 million as noted above).
- outline the projected maximum amount of investment earnings that could be considered for use in the upcoming budget, based on the priorities and parameters stipulated in this Policy; and
- include any other information pertinent to the Hydro Legacy Fund as deemed appropriate.

Haldimand County's website will contain a section devoted to the Hydro Legacy Fund where the public may access:

- information regarding the Hydro Legacy Fund Policy;
- any associated reports, including the above-noted Treasurer financial reports;
- notice of projects funded by the Hydro Legacy Fund, with a focus on promotion and awareness of such benefit;
- public notice of any meetings whereby uses of the Hydro Legacy Fund or changes to the Hydro Legacy Fund Policy will be considered; and
- any other relevant information.

With each term of Council, staff will review the Hydro Legacy Fund with the incoming Council. At that time, the if Council determines that further amendments to the Policy are required, staff proceed with opening up the Policy under the terms and guidelines outlined in Section 3.a).

Such above information related to the Hydro Legacy Fund will also be publicized through Haldimand County's social media network, as well as in the local newspapers, and specific signage at capital project locations, as deemed appropriate.