



**SUBJECT: Burlington Hydro business plan**

**TO: Corporate Services, Strategy, Risk & Accountability Cttee.**

**FROM: Finance Department**

Report Number: F-02-20

Wards Affected: Not applicable

File Numbers: 125-01

Date to Committee: February 13, 2020

Date to Council: February 24, 2020

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**Recommendation:**

Receive and file finance department report F-02-20 regarding the 2020 Burlington Hydro business plan.

**PURPOSE:**

This report is intended to provide committee with an overview as outlined in the 10-year business plan on the following:

- 10-Year Forecast of net income
- capital expenditures
- balance sheet
- dividend flow
- shareholder risks

**Vision to Focus Alignment:**

- Support sustainable infrastructure and a resilient environment

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**Background and Discussion:**

The shareholder direction to BEC (Burlington Enterprises Corporation) is a document that sets out the accountability, responsibility and relationship between the Board and

the Shareholder. Article 6 of the direction details reporting requirements to the shareholder. Specifically, section 6.1 requires that “not later than 30 days prior to the end of each fiscal year, the Board will approve and submit to the Chief Financial Officer of the shareholder a business plan for the next five fiscal years.”

The business plan is to include:

- (a) the strategic direction and any new business initiatives which Burlington Hydro or a subsidiary will undertake;
- (b) an operating and capital expenditure budget for the next fiscal year and an operating and capital expenditure projection for each fiscal year thereafter, including the resources necessary to implement the Business Plan;
- (c) pro forma unconsolidated Financial Statements for each fiscal year, including projected dividend payments to the shareholder;
- (d) an acquisition budget setting forth the nature and type of capital expenditures proposed to be made in the following fiscal year, supported by explanations, notes and information upon which the budget was based;
- (e) energy conservation programs and environmental plans; and
- (f) any material variances from the Business Plan then in effect.

This information is important to the City as it helps the City, as shareholder; understand the financial and operational aspects of the distribution business and other businesses of the corporation. The City is in receipt of the following financial information, including 10-year forecasts, with regards to BHI (Burlington Hydro Inc.) and BESI (Burlington Electricity Services Inc):

- (a) Business Assumptions
- (b) Balance Sheet
- (c) Statement of Changes in Cash Flow
- (d) Profit & Loss Statement
- (e) Capital Forecast

The general requirements of the shareholder direction have been addressed. Report CM-10-19 presented to Committee of the Whole on May 13, 2019 recommended governance changes to Burlington Hydro. As a result, BHEI (Burlington Hydro Electric Inc. is now Burlington Enterprises Corporation (BEC). Its subsidiaries remain BHI and BESI.

Each year the Board of Directors conducts a strategic planning process which helps formulate company objectives and strategic goals for the coming year. Understanding that as a shareholder the City of Burlington has a low tolerance for risk, the BEC Board

has directed management towards a risk-adverse strategy. The following strategies have been developed to support achievement of key objectives in 2020:

- Responsible Financial Management – LDC profitability and revenue growth
- Community commitment – customer satisfaction, corporate communications campaigns, customer focus performance metrics
- Operational effectiveness – information technology, improve organizational design
- Employer of choice – strengthen employee culture, meet safety metrics, strengthen customer/contractor communications

The strategic principles that support the objectives are:

- Optimize revenue considering capital requirements
- Institute a culture of continuous improvement identifying areas where effectiveness of the organization can be improved
- Refine and develop tools and training for customers and staff to help with education on prevailing issues
- Identify and pursue opportunities to grow revenues through non-regulated activities
- Evaluation of M&A proposals using key principles that include adding value for the City and positioning the utility strategically for the future
- Survey and consult staff on the level of job engagement

BEC remains focused on the needs and priorities of the community into the future. In alignment with the City's 25-year vision, the key strategic directions were identified for the future state 25 years out. Elements of the vision include:

- Strong shareholder relationship
- Unsurpassed reliability
- Excellent shareholder value
- Customers engaged and satisfied
- Unmatched safety record
- GREEN leader
- Top employer

The corporation is well positioned in the context of the City of Burlington's 25-year vision and its companion document From Vision to Focus which details more specific action plans for the next four years. Specifically, Burlington Hydro can contribute to supporting sustainable infrastructure and a resilient environment.

## **BURLINGTON HYDRO INC**

### **BHI NET INCOME FORECAST 2020-2029**

Forecasted net income ('000 millions) before tax for the next ten years is presented as follows:

	2019	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
	Update	Budget	Budget	Fcst								
Net Income	3.888	3.182	2.926	5.383	5.516	5.454	5.602	5.957	6.359	6.514	6.688	7.158

The 2019 update of \$3.888 million presents a positive variance of approximately \$706,000 from the 2019 budget of earnings before tax of \$3.182 million.

Factors affecting the 2019 forecast are as follows:

- Distribution revenue is forecast to drop below budget by (\$176K). This is primarily attributable to volume variances. The success of CDM (conservation and demand management) programs is supported by a decrease in the needs of the larger commercial/industrial customer base. Weather also had a material impact on demand.
- Other Operating revenue is forecast to exceed budget by \$623K.  
-Approximately \$500K has been recovered from the cancellation of the IESO Conservation First Framework (CFM) program. The recovery represents internal admin expenses that were incurred to run the program and were recoverable.
- Operating expenses are forecast to be over budget by (\$119K). An unfavourable variance in operations and maintenance costs and Administration Department costs is partially offset by a favourable variance in Billing and Collection.

The results achieved by BHI are of importance to the shareholder as the dividends flowing to the shareholder from BEC are composed of earnings from BHI and BESL.

### **TEN-YEAR CAPITAL BUDGET AND FORECAST**

In keeping with BHI's Asset Management strategy the capital budget and forecast identifies projects that are part of its sustaining capital budget as well as ensuring that Burlington has an adequate supply of electricity. These include:

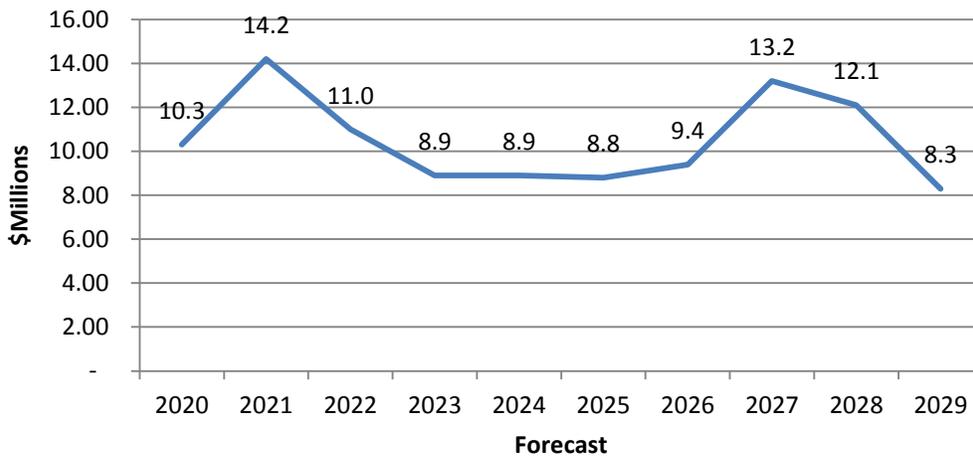
- Customer demand projects including connecting new customers, building new subdivisions and relocating system plant for roadway construction work.
- Renewal which focuses on replacement of assets that have reached end of useful life. New assets require less maintenance, deliver better reliability and reduce safety risks to the general public.
- Security which could include adding switching devices or creating a backup feeder supply to reduce the risk to typical restoration times.
- Reliability which supports maintenance of or improvement to the Service Quality indices measured and submitted to the OEB each year.
- Substations which are invested in to improve or maintain reliability to large numbers of customers and to maintain security and safety at the substation sites. The renewal or retirement of Burlington Hydro's 4.16 kV substations is part of the annual review undertaken as part of the Asset Management strategy.
- Customer Connections and metering include meter installations, meter upgrades and the capital components of wholesale and retail meter verification activities.

There are also special projects which are outside the sustaining capital program. These are:

- Capacity improvements for new customer connections and increased demand of existing customers.
- Developer Buybacks which involves BHI purchasing new subdivision assets as they are put in place by developers.
- Regulatory Requirements which are system capital investments driven by regulatory requirements. These directions may come from the OEB, IESO, the Ministry of Energy or the Ministry of the Environment.

Forecasted capital expenditures from the Business Plan are presented as follows:

### BHI Forecasted Capital Expenditures (2020-2029)



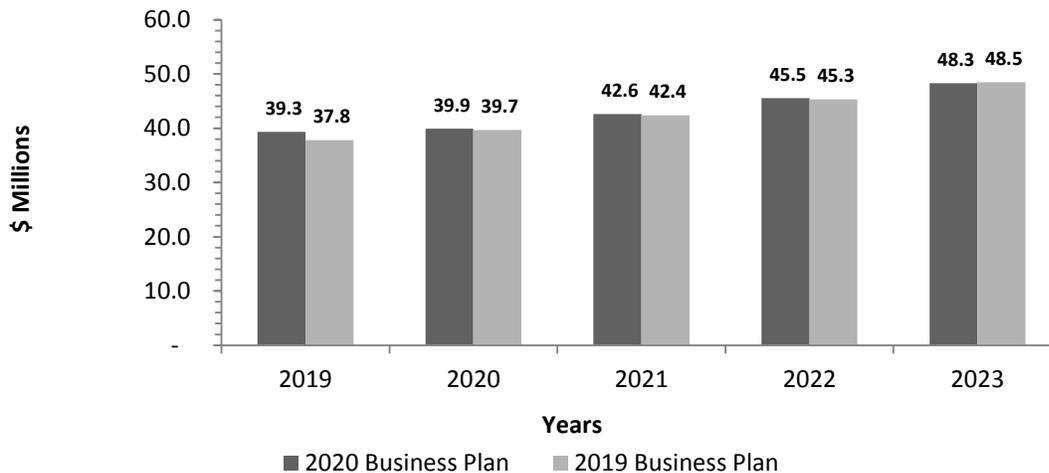
The 2020 capital budget has been developed using data from the asset management plan. The focus on maintaining the distribution system remains.

### BALANCE SHEET

#### (i) Retained Earnings

BHI continues to forecast retained earnings growth that represents value of increased ownership in a larger company. The following chart illustrates retained earnings growth forecast in the first five years of the 2020 business plan:

### Projected Retained Earnings



#### (ii) Long Term Debt

Funding has been in place with Infrastructure Ontario since 2010 for financing the Smart Meter program. This loan has a 15-year amortization period at a fixed rate of 4.51%.

Outstanding at year end 2020 will be \$4.3 million. A second loan that assisted with financing the Hydro One Transformer Station capital contributions has a 25-year amortization period at a fixed rate of 4.02%. Outstanding at year end 2020 will be \$6.3 million.

A third loan has a 15-year amortization period at a fixed rate of 3.63%. The loan matches long-term funding against BHI capital expenditures including the true-up payment for the Tremaine transformer station and the two Tremaine breakers. Outstanding balance at year end 2020 will be \$6.3 million.

No additions to long term debt are proposed for 2020.

The forecast also includes the costs of maintaining a \$10 million operating line of credit for working capital needs and an \$18 million letter of credit facility to cover prudential requirements related to the monthly power bill with the IESO.

## **BURLINGTON ELECTRICITY SERVICES INC. (BESI)**

BESI is the sister company to the distribution company BHI. Unlike BHI, which is closely regulated by the OEB, BESI operates as an unregulated business. Its divisions include:

**Streetlights** – In July 2017 BESI was successful in signing the Street light contract with the City of Burlington. The contract involved the supply and installation of LED Luminaries to replace existing high-pressure sodium streetlights. The contract is now complete. There are no costs or revenues associated with this division in the 2020 Budget.

**Festival of Lights Division** – This division contains the annual costs of operating the Festival of Lights net of any sponsor donations.

**Region Billing Division** – provides water billing services for the Region of Halton. The contract continues to contribute net income to the company.

**Solar Array Division** – Its revenues are derived from a solar array which was connected in 2012 to the City's Fire hall 8. General maintenance of the array is the division's operating costs.

**Vehicle Charging Station Division** – installs charging stations for electric vehicles. Revenue is rental revenue from the stations. The program paves the way for key information on homeowner interaction with EV's and the electricity grid.

**Mobile Turbine Co-Generator Division** – This division holds the Mobile Turbine Co-Generator situated in the South Parking Lot of the Brant Street Office.

**Control Room Division** – This division provides control room monitoring.

**Suite Metering Division** – Provides suite metering services.

Operating expenses for BESI cover salaries and benefits, consulting services, legal services, promotion and marketing costs. These are forecast to be unfavourable by (\$18K). Starting in 2020 Joe Saunders has been appointed President of BESI.

Overall net income after tax is forecast to have a positive variance of \$4K. Favourable variances in the Festival of Lights, Water Billing and Control Room Services are offset by Unfavourable variances in the other divisions.

## DIVIDENDS

Annual dividends paid to the shareholder are composed of dividends from BHI operations, BHI working capital and BESI net income.

\$ Millions

	2020 Budget	2021 Fcst	2022 Fcst	2023 Fcst	2024 Fcst	2025 Fcst	2026 Fcst	2027 Fcst	2028 Fcst	2029 Fcst
Dividends - BHI	2.0	2.1	2.0	2.1	2.1	2.1	2.0	2.1	2.1	2.1
Dividends - BESI	0.6	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Total Dividends to Shareholder	2.6	2.5	2.4	2.5	2.5	2.5	2.4	2.5	2.5	2.5

The dividend forecast is reduced by \$200,000 starting in 2021 over the previous business plan. This is required capital for BESI to consider a new value stream related to suite meters and EV chargers. While they were able to access a capital loan facility equity is needed to secure the loan. The impact to the City of Burlington is discussed below in the Financial Matter section of this report.

## SHAREHOLDER RISKS AND OPPORTUNITIES

### (I) Regulatory/Political Risk

As a regulated business, BHI is subject to the direction of Government legislated boards and committees. The 2018 provincial election saw a change in government that has impacted the utilities particularly in the area of conservation demand management programs which have been centralized under the IESO. Incentives related to the demand management program are

no longer paid to the local utilities. Issues related to electricity are expected to remain in the public view.

(II) Cost of Service Review

The OEB has established a five-year cycle in which the local distribution companies must undergo a full “cost of service” review. BHI will prepare a cost of service application in 2020 for 2021 rates. As a result of the 2014 cost of service review, the City was impacted by having the interest rate on the promissory note dropped from 5.87% to 4.88%. The current Hydro business plan projects the rate at 4.13% resulting in a decrease of (\$359K) interest income to the city beginning May 1, 2021. The current rates as of November 1/19 are 3.21%. The original interest rate on the note was 7.25%. City staff have taken a conservative approach in the cash flow forecast for the capital program.

The following outlines actual cash flow received by the City from BEC (formerly BHEI):

\$ Millions	2001-2011	2012	2013	2014	2015	2016	2017	2018	2019
Dividends	38.4	2.5	3.3	2.5	2.5	3.6	2.6	3.4	2.6
Interest	34.2	2.8	2.8	2.5	2.3	2.3	2.3	2.3	2.3
Interest on RESF	4.9	0.8	0.8	0.7	0.7	0.7	0.7	0.5	0.5
Total	77.5	6.1	6.9	5.7	5.5	6.6	5.6	6.2	5.4

(III) Opportunities

It is through BESI, the unregulated company that the shareholder has opportunities for strategic initiatives. BESI has set out as part of its overall business strategy to pursue in-scope services and new business ventures. Services that might be pursued would be intended to minimize risk to the taxpayers while representing an opportunity to establish and/or enhance existing common or shared services. Working strategically with Hydro management presents the City with an opportunity to find creative solutions that will ensure fiscal sustainability.

(IV) ERM (Enterprise Risk Management)

In 2015 the Hydro Board gained an appreciation of ERM. A high-level risk management review identified the wide range of risks to which the BHI organization may be exposed. These were narrowed down to a list which was analyzed in more detail. They were examined for the risk profile, current state and future considerations. This list; shown below provides the framework for a Risk Management Plan. The 2020 business plan includes a full analysis of each of the identified risk areas.

- Safety
- Public Safety
- Aging Infrastructure
- Reliability-Systems issues
- Head Office Building
- Workforce Sustainability
- Reputational
- Financial
- Regulatory/Political

Execution of the plan will be important to the City as shareholder as it allows the Hydro Board and Management to manage risk for the organization.

### **Financial Matters:**

As per the Hydro Business Plan as presented above the following are notable areas that will have an impact to the city's Hydro reserve fund.

First, is the decline in the dividend by \$200,000 annually beginning in 2021. The City currently receives an annual dividend of \$2.6 million and this will reduce to \$2.4 million next year. It is likely that this reduction will continue.

Secondly, is the interest that the city receives on its promissory note. Since 2014 the city has received an annual rate of 4.88% equating to an annual cash flow of \$2.3 million. As mentioned above Hydro anticipates a reduction in the rate to approximately 4.13%. This equates to an annual reduction of \$360,000. Upon the completion of the cost of service review should the rate be lower this could have an even greater impact on the cash flows to the Hydro reserve fund. Based on the recent 2019 rate approvals of 3.21% this would impact the city by \$800,000 annually from our 2020 amount.

Overall as per the Hydro 2020 Business plan the City with certainty will experience an overall reduction in cash flow to the Hydro reserve fund of \$560,000 annually with the potential for a greater impact in 2021.

The City's Hydro reserve fund is an integral part of the City's capital infrastructure program. It provides \$2.1 million annually to support the annual capital renewal program. Furthermore, it is anticipated over the next five years to be providing for the

annual average repayment of \$2.5 million in debt charges on special circumstances debt towards major capital projects of varying types throughout the city. As well the reserve fund is relied on for the City's storm allocation program until 2024 and direct cash contributions towards capital projects.

The Hydro reserve fund is being closely monitored and adjustments will be made as required in order to ensure a sustainable reserve fund balance.

Lastly, effective in 2019 the OEB changed the streetlight attachment rate from \$22.35 to \$43.63. With the OEB's 2020 inflation rate applied, the 2020 rate will be set at \$44.50. The City has 4,796 poles with streetlight attachments. To assist the City, BHI absorbed the price impact of \$102,000 for 2019. By not passing the increase on to the City in 2019, Burlington Hydro has "in effect" paid a special dividend of \$102,000. The 2020 impact of the rate increase is \$106,000 and will impact the City's operating budget.

## **Climate Implications**

BEC has identified areas in the City's 25-year strategic plan where it has a role to play in aiding the City to realize the strategic vision. These are:

### **Economic Growth**

- Energy-efficient buildings and other onsite sustainable features are the norm, thereby improving Burlington's environmental footprint. Existing buildings are being renovated to improve efficiency.
- Create employment lands vision to unite the community, developers and industry
- 15,000 new knowledge-based jobs by 2025

### **Environmental Leadership**

- The city's operations are net carbon neutral.
- The city achieves its major goals outlined in the Climate Action Plan
- Better environmental outcomes to improve quality of life, economic competitiveness and foster civic pride.

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## **Enterprise Risk:**

- Financial Sustainability
- Climate Change
- Growth & Affordability
- Legislative Changes

### **Engagement Matters:**

Burlington Hydro has engaged in a Customer Value Proposition Campaign over the period of 2017-2020. The goals of the campaign are to deliver on four priorities:

1. Bring together various elements the company makes with customers/stakeholders to ensure a consistent “value proposition” message
2. Engender trust and confidence across all stakeholder and customer audiences
3. Extol the virtues of the value of electricity in our everyday lives.
4. Engage all classes of customers and provide practical examples and success stories of how they deliver value back to the customer and through to the community.

In January 2020 Burlington Hydro launched a survey which gives customers the opportunity to provide input on capital spending priorities.

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### **Conclusion:**

As shareholder, the City has noted the commitment to risk management evidenced in this business plan. The City is appreciative of the efforts of the Board of Directors and Hydro Staff in continuing to manage this valuable City asset in a highly effective manner as reflected by the continued strong results forecast in the business plan and realized in the current year. The City’s 10-year Capital Financing Strategy is heavily dependent on both annual dividends and interest on the note receivable.

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Respectfully submitted,

Sandy O’Reilly

Controller and Manager of Financial Services

Ext 7648

### **Report Approval:**

All reports are reviewed and/or approved by Department Director, the Chief Financial Officer and the Executive Director of Legal Services & Corporation Council. Final approval is by the City Manager.